In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

Supreme Court, U.S.
FILED
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MICHAEL RODAK, JR., CLERK

TOUCHE ROSS & CO.,

Petitioner,

—*v.*—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,
Petitioner,

— *v.* —

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

OPINIONS BELOW

The majority, concurring and dissenting opinions of the United States Court of Appeals for the Second Circuit (A.190-A.224[1]) are not yet officially reported, and are unofficially reported at [Current Binder] FED. SEC. L. REP. (CCH) ¶96,404. The opinion of the United States District Court for the Southern District of New York (A.169-A.187) is reported at 428 F.Supp. 483.

[1] Numerals preceded by the letter "A." refer to pages of the separate Appendix filed herewith.

JURISDICTION

The judgment of the Court of Appeals (A.225-A.226) was entered on April 21, 1978. The Court of Appeals denied a timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (A.227-A.228). The petition for a writ of certiorari was filed on August 23, 1978, and was granted on November 27, 1978. 47 U.S.L.W. 3368. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES AND RULES INVOLVED

This case involves the following statutes and rule, as in effect in 1972: Sections 17(a) and 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§78q(a), 78r(a); Rule 17a-5 of the Securities and Exchange Commission, 17 C.F.R. §240.17a-5; and Sections 6(b)(1) and 6(f)(1) of the Securities Investor Protection Act of 1970, 15 U.S.C. §§78fff(b)(1), 78fff(f)(1). It also involves Rule 17(a) of the Federal Rules of Civil Procedure. Those statutes and rules are set forth in the appendix annexed to this brief.

QUESTIONS PRESENTED

1. Does Section 17(a) of the Securities Exchange Act of 1934, which requires the filing of certain reports by a securities brokerage firm, create in favor of customers of the brokerage firm an implied private right of action against accountants who audited such reports for damages resulting from misstatements therein, even though Section 18(a) thereof already expressly provides a limited private damage remedy for such misstatements, and even though the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)?

2. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is a Trustee liquidating the business of the brokerage firm pursuant to the Securities Investor Protection Act of 1970 entitled to assert such implied right of action on behalf of customers whose property he is unable to return in the course of the liquidation?

3. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is Securities Investor Protection Corporation, upon advancing funds to the Trustee for the payment of claims of customers pursuant to the Securities Investor Protection Act of 1970, subrogated to such implied right of action of such customers, even though the Act expressly provides (in Section 6(f)(1)) only that Securities Investor Protection Corporation is subrogated, upon the advancement of such funds, to customer rights against the estate of the brokerage firm, and not to customer rights against third-parties such as accountants?

STATEMENT OF THE CASE

This is the second of two separate, but practically identical, actions commenced against petitioner Touche Ross & Co. ("Touche Ross") by respondent Edward S. Redington (the "Trustee"), as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), and respondent Securities Investor Protection Corporation ("SIPC"). This federal action—like the still-pending first action (the "State Court Action"), which was commenced in the New York State courts almost ten months earlier—arises out of the failure in May 1973 of Weis, a now defunct brokerage firm, and its still ongoing liquidation pursuant to the Securities Investor Protection Act of 1970 ("SIPA"), and seeks to impose liability of over $65,000,000 on Touche Ross, a firm of certified public accountants, because of alleged misstatements in Weis financial reports (the "1972 Weis financial reports")

covering periods ending May 26, 1972, which were audited by Touche Ross.

In this action, the Trustee and SIPC not only assert the same common law claims of accountants' negligence and malpractice, breach of contract and breach of warranty already asserted in the State Court Action, but also seek to "federalize" those claims, and thereby to gain access to the federal courts, by alleging that the conduct of Touche Ross which gave rise to the common law claims also violated Section 17(a) of the Securities Exchange Act of 1934 (the "1934 Act"). Section 17(a), which is one of the reporting provisions of the 1934 Act, requires the filing by broker-dealers of reports prescribed by the Securities and Exchange Commission (the "SEC"). The Trustee and SIPC—who concededly are unable to assert the sole *express* private damage remedy for misstatements in Section 17(a) reports, which is provided by Section 18(a) of the 1934 Act and which is limited to certain purchasers and sellers of securities—therefore contend that Section 17(a) itself provides an implied damage remedy which they may assert. That contention was rejected by the District Court, which dismissed the Section 17(a) claims for failure to state a claim upon which relief can be granted, and the common law claims for lack of subject matter jurisdiction; was in part accepted (for the first time since enactment of the 1934 Act) over a strong dissent by a divided Court of Appeals, which reversed the District Court; and raises the issues now before this Court for decision.

A. The Failure of Weis, The Appointment of The Trustee And The Indictment Of The Weis Officers.

In April or May 1973, the SEC and the New York Stock Exchange (the "Exchange") learned of a seriously deteriorating financial situation at Weis and of apparent

violations of the 1934 Act by Weis and its officers (A.9 [¶13], A.127 [¶8]). In May 1973, the SEC sought, and the United States District Court for the Southern District of New York granted, an injunction barring Weis and five of its officers (the "Weis Five") from conducting business in violation of the 1934 Act (A.10 [¶14], A.127 [¶9]). At the same time, SIPC applied for a decree adjudicating that the customers of Weis were in need of the protection of SIPA, and the District Court granted such a decree and appointed the Trustee to liquidate the business of Weis (*id.*). *See, e.g., Aldrich* v. *Redington (In re Weis Securities, Inc.)*, ___F.2d___, [1977-78 Transfer Binder] BANKR. L. REP. (CCH) ¶66,884 at 76,861-76,863 (2d Cir. 1978), *petition for cert. filed sub nom. Grossmann* v. *Redington,* 47 U.S.L.W. 3333 (Nov. 4, 1978) (No. 78-746); *Exchange National Bank* v. *Wyatt,* 517 F.2d 453, 455 (2d Cir. 1975); *Rich* v. *New York Stock Exchange,* 522 F.2d 153, 156 (2d Cir. 1975); *United States* v. *Solomon,* 509 F.2d 863, 864-865 (2d Cir. 1975); *Aldrich* v. *New York Stock Exchange, Inc.,* 446 F.Supp. 348, 352 (S.D.N.Y. 1977); *Rich* v. *Touche Ross & Co.,* 415 F.Supp. 95, 98 (S.D.N.Y. 1976).

In connection with the Weis collapse, the Weis Five were indicted in July 1973, in *United States* v. *Arthur Levine, et al.* (S.D.N.Y. 73 Crim. 693), for conspiracy, securities fraud, mail fraud, maintenance of false books and records, and filing of false Section 17(a) reports (A.117). Four of them, including Arthur Levine (former Chairman of the Board and Chief Executive Officer), Sol Leit (President and Chief Operating Officer), Joel Kubie (Comptroller and Executive Vice-President), and Robert Lynn (Assistant Comptroller and Vice-President), pleaded guilty to single counts of the indictment; the fifth, Alan Solomon (Treasurer and Executive Vice-President), was found guilty on one count after a non-jury trial, and his

conviction was affirmed (*see* A.117). *See United States* v. *Solomon, supra,* 509 F.2d at 865; *Aldrich* v. *New York Stock Exchange, Inc., supra,* 446 F.Supp. at 353, 355; *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.[2]

B. The Commencement Of The State Court Action In July 1975.

On July 3, 1975, the Trustee and SIPC commenced the still-pending State Court Action in the Supreme Court of the State of New York, County of New York, under the title (which is the same as the title of this action) *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76) (A.116, A.121-A.122, A.171, A.194).[3] The State Court Action involves the same parties as does this federal action, and the complaint there (A.123-A.145) makes the same factual allegations, asserts essentially the same claims and seeks the same aggregate damages of $65,000,000 as does the complaint here.[4] Although the State Court Action has been relatively inactive, Touche

[2] The SEC complaint, the indictment of the Weis Five and the criminal docket sheet showing the guilty pleas and verdict, although not reproduced in the separate Appendix, are in the Record as, respectively, Exhibits 4, 5 and 6 to the Roth moving affidavit (*see* A. 117).

[3] The State Court Action "has a 1976 number because the first paper filed in the action was in 1976" (A.171).

[4] The only material difference between the State Court Action and this action is the addition in the complaint here of the few allegations that the Trustee and SIPC deemed necessary to assert their Section 17(a) claims — *i.e.*, the few allegations by which they seek to "federalize" what are essentially nothing more than common law claims of accountants' negligence and malpractice. As the Court of Appeals majority put it, "[t]he common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under Section 17 of the [19]34 Act were omitted. Five of the Trustee's six present 'causes of action' appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims" (A.194).

Ross has commenced discovery therein (A.116, A.195 n.7).[5]

C. The Commencement Of This Action In April 1976.

On April 30, 1976, almost ten months after they had commenced the State Court Action, the Trustee and SIPC commenced this federal action (A.1, A.116, A.171, A.194).

D. The Complaint Herein.

1. GENERALLY.—The complaint herein (A.5-A.111), the factual allegations of which are deemed to be true for present purposes, contains six "causes of action" on behalf of the Trustee and eight on behalf of SIPC. Each of the "causes of action" is based upon the same set of "common allegations".

2. THE PARTIES.—The complaint alleges that the Trustee was "duly appointed" by order of the District Court dated May 30, 1973 (A.6 [¶5]). SIPC is alleged to be "a non-profit membership corporation created by and organized under" SIPA, and Weis is alleged to have been "a member of SIPC" (A.7 [¶6]). Touche Ross is alleged to be "a partnership of certified public accountants," which was engaged by Weis in 1969 as "its independent certified public accounting firm" and continued to act as

[5] The Trustee and SIPC have taken the position that the State Court Action was "commenced first only in a highly technical sense . . . [*i.e.*,] by service of a summons without a complaint (the complaint was not served until after the filing of the federal complaint)" (A.195 n.7), and is "practically dormant" (A.153-A.154). Even accepting those characterizations for present purposes (*but cf.* A.164-A.168), they miss the point. The significant thing about the State Court Action is not when the complaint therein was or was not served, and not whether it is or is not "dormant", but rather that it reflects that the facts on which the Trustee and SIPC base their claims have been understood by them since long prior to the commencement of this action to give rise to basically common law claims that may be pursued in the State courts.

such "until about May 1973, when the forced liquidation of Weis commenced" (A.7 [¶7]).

3. THE JURISDICTIONAL ALLEGATIONS.—The significant jurisdictional allegations for present purposes are that, with respect to its purported federal aspects, "the action arises . . . under Section 17" of the 1934 Act, and the District Court "has jurisdiction over . . . [the Section 17] claims by virtue of Section 27 of the 1934 Act" (A.5-A.6 [¶¶1-3]). Jurisdiction of the "common law" claims allegedly exists under "principles of pendent jurisdiction" (*id.*).[6]

4. THE "COMMON" ALLEGATIONS.—The complaint contains a group of so-called "common" allegations (A.7-A.21 [¶¶8-31]), which set forth the alleged factual basis for, and are expressly realleged in their entirety in, each of its "causes of action". The "common" allegations assert that Weis was a broker-dealer registered with the SEC and a member of the Exchange (A.7 [¶8]), and that events which had come to light in April and May 1973 by reason of "separate investigations by the Exchange and the SEC" resulted in Weis' liquidation pursuant to SIPA, which was ordered by the District Court on May 30, 1973 (A.9-A.10 [¶¶ 13, 14]).

The "common" allegations also assert that the Weis Five "misstated the financial condition and results of

[6] The complaint also alleges jurisdiction over the Trustee's common law claims by virtue of certain provisions of the Bankruptcy Act incorporated into SIPA (A.6 [¶2]). As noted hereinafter (pp. 14, 15 n.10, 17, *infra*), the District Court held that there was no such jurisdiction, the Court of Appeals expressly declined to pass on the issue, and this Court has not acted on the Trustee's cross-petition for certiorari in No. 78-493 seeking review of the District Court decision. The complaint also alleges jurisdiction of the common law claims under §§1331, 1332 and 1334 of the Judicial Code, 28 U.S.C. §§ 1331, 1332, 1334 (A.6 [¶¶2-3]), but the Trustee and SIPC abandoned such jurisdictional contentions after they too were rejected by the District Court.

operations of Weis" in the 1972 Weis financial reports in order to "create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000", whereas "Weis had actually suffered losses . . . in excess of $1,500,000" (A.8 [¶10]); that the 1972 Weis financial reports "were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act" and "were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders" (*id.*); that if "Weis' actual [1972] financial condition . . . [had] been truthfully reported", Weis' forced liquidation in 1973 "would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved" (A.8-A.9 [¶11]); and that even "if a liquidation of Weis had been necessary . . . such liquidation could have occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later" (*id.*).

Liability is sought to be imposed upon Touche Ross by reason of its allegedly improper audit and certification of the 1972 Weis financial reports (A.12 [¶19], A.13-A.14 [¶24]). It is alleged that Touche Ross "knew or should have known" that its engagement "was a requirement of the Exchange" and "was for the benefit both of Weis . . . and of persons other than Weis", and that "its examination of and report on Weis' financial condition were a requirement of Section 17 . . . and the rules and regulations promulgated thereunder" (A.12-A.13 [¶¶20, 22]); that Touche Ross "purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972" and in connection therewith "certified" and "issued . . . opinion letters" with respect to the 1972 Weis financial reports (A.13-A.14 [¶¶23, 24]); that Touche Ross "knew, should have known and intended" that Weis, its Board of Directors, the SEC, the Exchange, SIPC, customers, cred-

itors, lenders and shareholders "would rely" on its opinion letters and the 1972 Weis financial reports for various purposes (A.14-A.15 [¶¶25-27]); and that Touche Ross "breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner, and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner" (A.15-A.16 [¶28]).[7]

The "common" allegations then assert that various consequences followed "[a]s a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards . . . [and] accounting principles, and the audit regulations of the Exchange and the SEC" (A.19-A.21 [¶31]). It is alleged that, among such consequences, "the Weis Five were able to continue to make false and fictitious entries"

[7] Although the allegations that Touche Ross improperly audited and certified the 1972 Weis financial reports are assumed to be true for present purposes, it is noteworthy that in the "SEC . . . action in [the District] Court (73 Civ. 2332) against Weis and the Weis Five for injunctive relief" (A.10 [¶14]), the SEC complaint alleged violations of the securities acts in connection with the 1972 Weis financial reports *only against Weis itself and the Weis Five* (A.116-117). Even after the "separate investigations by the Exchange and the SEC" alleged by the Trustee and SIPC here (A.9 [¶13]), the SEC complaint did not allege that Touche Ross had committed or participated in or aided and abetted any such violations. Moreover, the indictment filed in the District Court against the Weis Five in *United States* v. *Arthur Levine, et al.* (S.D.N.Y. 73 Crim. 693) reveals that Touche Ross was as deceived as anyone else by the Weis Five. Thus the indictment expressly alleges in Count I (p. 5) that the Weis Five "*did fraudulently conceal from Weis' auditors, Touche Ross & Co.*, the existence and nature of the aforesaid fraudulent books and records and, in addition, . . . did create directly and indirectly wholly fictitious documentation for the aforesaid fraudulent entries" (emphasis added)—allegations which three of the Weis Five (Levine, Leit and Kubie) admitted by pleading guilty to Count I (A.117). *See* the SEC complaint, the indictment and the criminal docket sheet showing the guilty pleas (referred to at p. 6 n.2, *supra*). *See also Aldrich* v. *New York Stock Exchange, Inc., supra,* 446 F.Supp. at 352, 355; *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

during 1973 (A.19 [¶31a]); "Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules" (A.19 [¶31c]); "Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from . . . taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis . . . could have been prevented" (A.20 [¶31d(iii)]); and "the assets of Weis were wasted and mismanaged" (A.20 [¶31h]).

5. THE TRUSTEE'S CLAIMS. — On the basis of the "common allegations", the Trustee asserts six "causes of action" (A.21-A.24 [¶¶32-49]), the first of which is his federal claim under Section 17, and the other five his common law claims. Each of his "causes of action" seeks alleged damages of at least $51,000,000, and is asserted both on behalf of Weis in its own right and on behalf of customers of Weis whose property the Trustee was unable to return because of the "depletion of the property held by Weis in trust for its customers" (A.9 [¶12], A.19-A.22 [¶¶31(d)-31(i), 34, 35]).

The Trustee's only federal claim is his first "cause of action" (A.21-A.22 [¶¶32-35]), which alleges that, by reason of the "errors and omissions" alleged in the "common" allegations, Touche Ross "violated, and aided and abetted the Weis Five in violating, Section 17 of the 1934 Act . . . and the rules and regulations promulgated thereunder" (A.21 [¶33]). The Trustee's second through sixth "causes of action" are common law claims of accountants' negligence and malpractice (A.22-A.23 [¶¶36-42]), breach of contract (A.23 [¶¶43-45]) and breach of warranty (A.24 [¶¶ 46-49]).

6. SIPC's CLAIMS. — On the basis of the "common" allegations, SIPC asserts eight "causes of action" (A.24-A.31 [¶¶50-85]), the first four of which are its federal claims under Section 17 and the other four its common law claims. Each of the "causes of action" seeks damages of at least $14,000,000 resulting from alleged depletion of the so-called "SIPC fund", from which SIPC allegedly provided to the Trustee "funds for the payment of claims submitted by customers and certain other creditors of Weis and for certain administrative expenses of the liquidation" (A.10 [¶15]). Four of SIPC's "causes of action" are asserted to recover in SIPC's own right damages that it allegedly suffered (A.25 [¶53], A.27 [¶63], A.28 [¶72], A.30 [¶80]), and four are asserted by SIPC as a purported subrogee "subrogated to those claims which . . . the customers . . . of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross" (A.26 [¶57], A.28 [¶68], A.29 [¶76], A.31 [¶84]).

SIPC's first and third "causes of action" (A.24-A.25 [¶¶50-53], A.26-A.27 [¶¶59-63]) are SIPC's claims in its own right under Section 17, the first alleging that Touche Ross violated Section 17 and the third that it aided and abetted the Weis Five's violation thereof. Its second and fourth "causes of action" (A.25-A.26 [¶¶54-58], A.27-A.28 [¶¶64-69]) are claims as a purported subrogee, the second alleging that Touche Ross violated Section 17 and the fourth that it aided and abetted.

SIPC's fifth through eighth "causes of action" are its common law claims of negligence and malpractice. The fifth and seventh "causes of action" (A.28 [¶¶70-72], A.29-A.30 [¶¶78-80]) assert such common law claims in SIPC's own right, and the sixth and eighth (A.29 [¶¶73-77], A.30-A.31 [¶¶81-85]) assert them for SIPC as a purported subrogee.

E. The Dismissal Of This Action By The District Court.

In the District Court, Touche Ross moved pursuant to Rule 12(b), F.R.Civ.P., to dismiss this action on the grounds, *inter alia*, that (i) the federal claims, being based solely on Section 17(a) of the 1934 Act, fail to state a claim upon which relief can be granted because Section 17(a) does not create any implied private right of action, and (ii) subject matter jurisdiction of the common law claims is lacking (A.112-A.113). The District Court, on the basis of a written opinion dated March 1, 1977 (A.169-A.187), and by order and judgment dated March 15, 1977 (A.188-A.189), granted the motion and dismissed the action.[8]

Noting in its opinion that "[i]n the 43 years during which the [1934 Act] has been on the books, there has been no decision whether a private right of action can be asserted for violation of Section 17" (A.177),[9] the District Court expressly held that no private right of action can be implied under Section 17(a). The District Court reasoned that, while there was no explicit statement of legislative intent with respect to such an implied right, the grant in Section 18(a) of an express and carefully limited remedy for misstatements in Section 17(a) reports (as well as for misstatements in reports filed pursuant to other reporting provisions of the 1934 Act) only to purchasers or sellers of securities in reliance upon such misstatements, "strongly

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[8] Touche Ross' motion also sought dismissal of certain of the common law claims for failure to state a claim upon which relief can be granted. Alternatively, the motion sought a stay of this action pending determination of the State Court Action. It was unnecessary for the District Court to reach, and it did not consider, those issues.

[9] As the District Court also noted (A.177), the question whether there is an implied private right of action under Section 17(a) of the 1934 Act expressly was left undecided in this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 n.13 (1976).

suggest[s] a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18" (A.178). The District Court also concluded that it is not "necessary to imply a civil liability under Section 17 in order to enforce its provisions" (A.180).

The District Court explicitly followed recent decisions of this Court which recognize that it would be anomalous and improper to impute to Congress an intention to permit an implied remedy under the 1934 Act broader than the express statutory remedies specifically provided therein, and which emphasize that creation by judicial interpretation of an implied private damage remedy is proper only if it is necessary to effectuate Congress' goals (*see* A.178, A.182-A.183). *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 734, 736 (1975); *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 25-26 (1977). The District Court also followed a decision of the Court of Appeals for the Third Circuit, *In re Penn Central Securities Litigation,* 494 F.2d 528 (3d Cir. 1974), and various district court decisions, which hold that the reporting provisions of the 1934 Act do not themselves, in view of the express remedy provided by Section 18(a) and its careful limitation by Congress to certain purchasers or sellers of securities, create any implied private rights of action (*see* A.179).

Having held that the federal Section 17(a) claims of the Trustee and SIPC should be dismissed, the District Court then held that pendent jurisdiction over their common law claims was lacking (A.184-A.187), and that there was no other basis for exercising subject matter jurisdiction over the common law claims. The District Court expressly rejected, *inter alia,* the Trustee's contention that provisions of the Bankruptcy Act incorporated into SIPA provided such jurisdiction (A.184-A.186).

F. The Reversal Of The District Court By The Court Of Appeals.

On April 21, 1978, a divided Court of Appeals (Lumbard and Timbers, C.J.J., constituting the majority) (A.190-A.209), over a vigorous and well-reasoned dissent (Mulligan, C.J.) (A.209-A.224), reversed the District Court and remanded for further proceedings. The Court of Appeals majority held that customers of brokerage firms are a class "peculiarly protected by" Section 17(a), and therefore have an implied private right of action thereunder against accountants for misstatements in audited reports filed pursuant thereto (A.195-A.201), but expressly declined to set forth "the appropriate standard for accountant liability in [such] actions" (A.204).[10] Moreover, while recognizing that neither the Trustee on behalf of Weis nor SIPC in its own right has any right of action under Section 17(a) because they are not within any class protected thereby, the majority also held that the Trustee, as "bailee" of customer property that he has been unable to return, and SIPC, as "subrogee" of customers for the payment of whose claims it has advanced funds, may assert such right of action (A.201-A.204).[11]

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[10] The Court of Appeals majority also expressed no opinion as to the District Court's holding that, absent pendent jurisdiction, there is no other basis for subject matter jurisdiction over the common law claims (A.192 n.3). Moreover, even though it permitted the Trustee and SIPC to assert federal claims under Section 17(a), the majority also expressly declined to determine whether pendent jurisdiction over the common law claims should be exercised (A.204).

[11] The SEC submitted in the Court of Appeals a brief *amicus curiae,* which the majority thought "materially aided" its decision (A.192 n.3), and of which Judge Timbers thought Judge Mulligan in dissent had "disparagingly" spoken (A.206-A.208). Judge Mulligan's so-called "disparagement" consisted of his pointing out not only that the SEC's position was erroneous, but also that, as made clear by this Court in *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 41 n.27, the views of the SEC are of only "limited value" in this kind of case (A.209 n.1). *See also, e.g., International Brotherhood of Teamsters* v. *Daniel,* ___ U.S. ___, 47 U.S.L.W. 4135, 4138 and n.20 (Jan. 16, 1979) ("On a number of occasions in recent years this Court

Judge Mulligan, in his forceful dissent, would have affirmed the order of the District Court. He concluded that there is no implied private right of action under Section 17(a) (A.209-A.222), and that, even if there were such a right in favor of brokerage firm customers, the Trustee and SIPC are not proper parties to assert such right of action to recover customers' damages (A.222-A.224).

The judgment of the Court of Appeals (A.225-A.226) was entered on April 21, 1978.[12] The Court of Appeals denied Touche Ross' timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (A.227-A.228).

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has found it necessary to reject the SEC's interpretation of various provisions of the Securities Acts"). As Judge Mulligan further noted, the position taken in the SEC brief—which had been submitted in support of SIPC's (but not the Trustee's) position—"was not only rejected below but was [in substantial part] repudiated by the majority in its footnote 13" (A.209 n.1).

[12] Within six days after the Court of Appeals decision, *customers* of Weis themselves commenced in the District Court a class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a) as the result of the collapse of Weis. *Rosen* v. *Touche Ross & Co.*, (S.D.N.Y. 78 Civ. 1943). This Court may (and hereby is requested to) take judicial notice of such action. *E.g., Massachusetts* v. *Westcott*, 431 U.S. 322, 323 n.2 (1977). Another class action on behalf of *customers* of Weis had earlier been commenced against Touche Ross in the District Court and dismissed on the ground that the 1934 Act claims there asserted did not state a claim upon which relief could be granted under Sections 10(b) and 18(a) of the 1934 Act, but were at most non-federal, common law claims for negligence and malpractice which should be determined by the State courts. *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95 (S.D.N.Y. 1976). After such dismissal, the *Rich* plaintiffs, as have other customers, commenced a State court class action asserting the customers' claims against Touche Ross (A.118, A.220 n.9).

G. The Granting Of Certiorari By This Court.

On August 23, 1978, Touche Ross petitioned this Court for certiorari to review the holding by the Court of Appeals majority that the Trustee and SIPC could assert implied private rights of action under Section 17(a). On September 22, 1978, the Trustee cross-petitioned for certiorari in No. 78-493 to review the District Court's holding (which the Court of Appeals did not consider) that the Bankruptcy Act provisions incorporated into SIPA do not provide subject matter jurisdiction for his common law claims. On September 27, 1978, SIPC conditionally cross-petitioned for certiorari in No. 78-526 to review the holding by the Court of Appeals majority, with which Judge Mulligan in dissent agreed, that SIPC may not assert any Section 17(a) claim in its own right.

On November 27, 1978, this Court granted Touche Ross' petition. 47 U.S.L.W. 3368. It appears that the cross-petitions are still *sub judice.*

SUMMARY OF ARGUMENT

I

A. The federal claims of the Trustee and SIPC are based solely upon Section 17(a) of the 1934 Act, which is one of the reporting provisions thereof and which requires broker-dealers to file reports prescribed by the SEC. Section 18(a) of the 1934 Act sets forth the sole express private damage remedy for misstatements in reports required by Section 17(a) and the other reporting provisions, but the Section 18(a) remedy is limited to purchasers and sellers of securities who have been damaged by reliance on the misstatements.

B. Neither the Trustee, nor SIPC, nor any customer whose claims they purport to assert is within that

purchaser-seller class and they thus cannot assert the Section 18(a) remedy. Therefore, the Trustee and SIPC contend—and the Court of Appeals held (for the first time since enactment of the 1934 Act)—that Section 17(a) itself creates in favor of brokerage firm customers an implied private right of action for damages for misstatements in Section 17(a) reports, and that the Trustee (as the purported "bailee" of customer property that he has been unable to return in the Weis liquidation) and SIPC (as the purported "subrogee" of Weis customers for the payment of whose claims in the liquidation SIPC has advanced funds to the Trustee) may assert that implied right against Touche Ross, the accountants who audited and certified the 1972 Weis financial reports, which were required to be filed under Section 17(a) and contained misstatements.

C. However, Section 17(a) does not create any implied right of action for damages resulting from misstatements in reports required thereby, and the Court of Appeals erred in holding to the contrary. The statutory scheme—with its express and carefully limited damage remedy in Section 18(a) for misstatements in Section 17(a) reports—reflects a Congressional intention that a damage remedy for such misstatements would be available only to the purchasers and sellers specified in Section 18(a), and requires the conclusion that it would be improper to imply an additional, broader damage remedy under Section 17(a) itself in favor of brokerage firm customers who are not purchasers or sellers.

Thus, this action does not present an appropriate situation for application of the factors set forth in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), upon which the majority improperly relied and which expressly limited application of those factors to determining "whether a private remedy is implicit in a statute not expressly providing one"—a

limitation again emphasized in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 27 (1977). The statutory scheme here—rather than being one where (as in *Cort* v. *Ash*) no express remedy whatsoever is provided for violation of the statute under which a remedy is sought to be implied—is one in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the remedy (Section 18(a)) it thought necessary and appropriate for violations of that requirement. Consequently, the controlling decisions are *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) *("Amtrak"),* and *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), which establish that, in light of the doctrine *expressio unius est exclusio alterius,* and in the absence of clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided; and *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), which recognizes that it is improper to imply broader remedies under the 1934 Act than the express statutory remedies specifically provided therein.

Since there is, as even the Court of Appeals majority conceded, no evidence of any Congressional intent to create an implied private right of action under Section 17(a), *Amtrak, Barbour,* and *Blue Chip Stamps* require a holding that Section 17(a) does not create any implied right of action. Moreover, as *Blue Chip Stamps* also makes clear, it is inappropriate to eliminate the purchaser-seller requirement of Section 18(a)—which is a part of the predominant pattern of the 1934 Act and the Securities Act of 1933 (the "1933 Act") to provide private remedies to those damaged in the purchase or sale of securities—by implying a Section 17(a) right of action not subject to that requirement. The purchaser-seller requirement of Section 18(a) is designed to avoid "vexatious litigation" by, *inter*

alia, ensuring that claims for damages caused by misstatements in reports required by the 1934 Act (including Section 17(a) reports) will be based upon concrete, "objectively demonstrable" actions (*i.e.,* the purchase or sale of securities) taken in readily demonstrable reliance on such reports, rather than—as here—upon speculative and unreliable claims as to what actions *might have* been taken by the SEC and other regulatory authorities with respect to the Weis situation, and what *could have* or *might have* or *might not have* occurred at Weis, had the allegedly true facts been known. Moreover, *Blue Chip Stamps* and other decisions of this Court reject any view that the purchaser-seller requirement is inconsistent with the principle that the 1934 Act is to be "flexibly" construed to achieve its "remedial" purposes.

Numerous recent decisions, including two decisions of the Third Circuit, recognize that the principles of *Amtrak, Barbour* and *Blue Chip Stamps* require the conclusion that Section 18(a) is the exclusive remedy for misstatements in reports required by the 1934 Act and that no other remedies should be implied from the reporting provisions themselves in favor of plaintiffs who are unable to satisfy the purchaser-seller requirement.

The Court of Appeals majority erred in that it misapprehended the statutory scheme of the 1934 Act and the importance of the express Section 18(a) damage remedy for misstatements in Section 17(a) reports; it improperly relied upon a *Cort* v. *Ash* analysis despite its express limitation to determining "whether a remedy is implicit in a statute *not expressly providing one*", 422 U.S. at 78, and its consequent inapplicability here in light of the existence of Section 18(a); it failed to apply the analysis required by the controlling decisions in *Amtrak, Barbour* and *Blue Chip Stamps;* it failed to take into account the various protections already provided by Congress for

brokerage firm customers by the regulatory scheme—protections which include preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970) both as part of the monitoring system and as a source of funds to pay customer losses, criminal and injunctive proceedings to deter violations of the regulatory scheme, and the availability of State law remedies; and it failed to recognize that Congress in limiting the express private damage remedy in Section 18(a) to purchasers-sellers necessarily intended that such a remedy *not* be added to the protections already provided for the customers.

D. Moreover, even where a private damage remedy is sought to be implied from a provision of the 1934 Act for which there is no express remedy whatsoever, *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25-26, holds that a private right of action is not to be implied unless it is "necessary" to effectuate the Congressional goals, *i.e.,* where the Congressional purposes are likely to be "undermined" absent private enforcement. The Court of Appeals majority failed properly to take into account the "necessity" factor of *Piper,* which requires a holding that there is no implied right of action under Section 17(a) because implication of such a right of action is not, and was not considered by Congress to be, "necessary" to effectuate the goals of Section 17(a), and because the Congressional purpose will not be "undermined" absent such an implied right.

The primary purpose of Section 17(a) is to provide for reports which are part of an extensive system of preventive monitoring intended to help prevent brokerage firm insolvencies, and not to create private lawsuits for damages after such insolvencies have occurred. The SEC has available to it investigative, criminal and injunctive proceedings to enforce compliance with the regulatory

scheme, including Section 17(a). Since 1970, when SIPA was enacted, the regulatory scheme has included SIPC, with not only the function of participating in the preventive monitoring of the brokerage firms and seeking liquidation of such a firm where necessary, but also with the function of ensuring that brokerage firm customers are protected against loss by providing funds to pay the losses of such customers. And, of course, there are available to such customers the usual State law remedies, including common law actions for damages against accountants.

Under such a regulatory scheme, it is not necessary to imply a private right of action under Section 17(a), and in the 45 years since enactment of the 1934 Act the regulatory scheme has operated without a single court other than the Court of Appeals majority here finding it appropriate—let alone necessary—to imply such a right of action. The criminal and injunctive sanctions, the threat of liquidation under SIPA, and the State law remedies are all available and are sufficient deterrents to Section 17(a) violations.

As *Piper* points out, the further deterrent effect of implying a private damage action is so speculative that it does not provide "significant additional protection." *Piper* also makes clear that the necessity test is not met simply because an implied Section 17(a) remedy would be consistent with the regulatory scheme, or because the SEC has practical limitations on its ability to monitor every brokerage firm. Furthermore, there is no need to obtain, by implying a Section 17(a) remedy, nationally uniform standards for actions brought to recover losses after a brokerage firm has failed; this is clear from *Piper* and from *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 478 (1977), which restated the principle that where State law remedies traditionally have been available, federal courts should be reluctant to intrude federal remedies into the

area to serve " 'at best a subsidiary purpose' of the federal legislation".

It is also important that the primary purpose of Section 17(a) differs from that of the prospectus, antifraud and proxy provisions, which are intended to provide data directly to investors to aid them in their investment (*i.e.,* purchase and sale) and corporate voting activities, with respect to which the SEC has only an oversight role, and with respect to which implication of private remedies therefore may be necessary to the extent that express remedies are not provided. Section 17(a) reports, on the other hand, are not intended primarily for use by investors, but rather for use by the SEC and other regulatory authorities in performing their functions. Investors thus are not normally directly affected by Section 17(a) reports in making investment decisions but are affected only consequentially by the overall success or failure of the SEC and regulatory authorities, and in that context there is no necessity to create judicially an implied damage remedy under Section 17(a).

E. As noted, the Court of Appeals majority erred in relying (despite the existence of the express Section 18(a) remedy for misstatements in Section 17(a) reports) upon the factors enumerated in *Cort* v. *Ash* for determining "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added), 422 U.S. at 78, and in failing properly to take into account the "necessity" factor which *Piper* requires as a part of any *Cort* v. *Ash* analysis. However, even if the factors specifically identified in *Cort* v. *Ash* were assumed to be the only appropriate ones for consideration, they too require the conclusion that Section 17(a) creates no implied private right of action and that the Court of Appeals majority erred in holding to the contrary.

First, the existence of Section 18(a) shows that insofar as private rights of action for damages may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided.* Second, the statutory scheme reflects a *legislative intent* to deny a Section 17(a) remedy, since Section 18(a) provides an express private right of action only for damages to purchasers and sellers of securities who rely in their securities transactions upon misleading reports filed under Section 17(a). Third, an implied right would *not be consistent with the legislative scheme* since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies. Fourth, the causes of action that the Trustee and SIPC allege normally are asserted in common law actions for accountants' negligence and malpractice, and the purchaser-seller requirement of Section 18(a) shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to State law* which, under "well established tort law principles" provides appropriate remedies—remedies which are being pursued as against Touche Ross by the Trustee and SIPC in the State Court Action, and by Weis' customers themselves, and to which they all appropriately should be relegated.

F. The Court of Appeals majority also erroneously relied upon *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), and its "statutory tort" theory, both of which have been significantly restricted by more recent decisions of this Court. *Borak* is distinguishable from this action, in that, *inter alia,* (i) there was no express remedy provided in the 1934 Act for violations of the proxy provisions of Section 14(a), the statutory provision there involved, whereas here Section 18(a) does provide an express remedy for

misstatements in Section 17(a) reports, (ii) Section 14(a) did not simply impose a reporting requirement, as does Section 17(a), and (iii) Section 14(a) dealt with proxy statements designed specifically to influence investor decisions (*i.e.,* corporate voting decisions), whereas Section 17(a) reports are primarily for the information of the SEC and other regulatory authorities, and are not intended primarily to aid or influence investors in their investment or voting decisions.

G. Serious policy considerations militate against implication of a private right of action under Section 17(a). First, such implication would significantly broaden the class of potential plaintiffs seeking to impose liability on accountants who perform services and render expert opinions with respect to matters under the 1934 Act beyond the purchaser-seller class Congress delineated in Section 18(a), thereby raising difficult issues that are legislative in nature but that have not yet been addressed by Congress. Section 17(a) and its legislative history do not provide any standards that would enable the courts properly to articulate the scope of any implied civil liability thereunder, and there is the danger that accountants would be held responsible for all damages that the regulatory authorities might have been able to prevent, and would virtually be made insurers of the regulatory scheme's success.

Second, such implication would have the serious potential for unnecessarily adding to the already large volume of litigation under the 1934 Act in the federal courts, and thereby further burdening them with, a substantial amount of additional litigation which essentially involves accountants' negligence and malpractice, and which traditionally has been, and more appropriately should be, adjudicated in the State courts. If such a right of action is implied, all customers of failed or failing

brokerage firms (and possibly even customers of brokerage firms which are not failing, of which there are over 5,000) will have a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports.

Third, and as already noted, such implication would eliminate the purchaser-seller requirement of Section 18(a) and, as recognized in ***Blue Chip Stamps,*** inordinately increase the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749.

Fourth, since Section 17(a) is a reporting provision, a holding that a private right of action may be implied thereunder would be authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have unsuccessfully sought to assert such implied rights, and affirmance of the holding of the Court of Appeals majority here only would give new impetus to such efforts.

II

A. Even if Section 17(a) were held to create an implied private right of action in favor of brokerage firm customers against their brokerage firm for misstatements in its Section 17(a) reports, it does not in any event create such an implied right against accountants. Section 17(a) neither mentions nor imposes any duty upon them. While SEC Rule 17a-5 does refer to accountants, it does not by its terms impose any duty on them, and any interpretation thereof that would impose such a duty would impermissibly expand the scope of the rule beyond the power granted to the SEC by Section 17(a).

B. Section 17(a) does not in any event create such a right in the absence of *scienter* (which the Trustee and SIPC do not allege), because any implied right of action based on negligence would be *broader* than the express remedy of Section 18(a), and would be inconsistent with this Court's recognition of *scienter* as a necessary element of implied remedies. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

III

A. Even if Section 17(a) did create implied private rights of action in brokerage firm customers against accountants, the Trustee is not entitled as a "bailee" to assert any such rights on behalf of the Weis customers whose property he has been unable to return. The Trustee succeeded only to the rights of Weis itself, and not to any rights of the Weis customers that Weis itself could not assert. The Trustee thus may assert rights as a "bailee" only to the extent that Weis could have asserted such rights. The common law doctrine of bailment that permits a bailee to sue a third party for loss of, or injury to, the bailed property is based on *the bailee's own possessory rights,* and not upon any theory that the bailee is the representative, or is asserting the rights, of the bailor. It treats the bailee, insofar as a third-party wrongdoer is concerned, as owner of the property for all purposes.

Thus, even if common law principles applied, they would provide no basis for the Trustee to assert any Section 17(a) rights of the customers. Any action brought by the Trustee as "bailee" necessarily is an action to vindicate Weis' own possessory rights—not those of the customers. But Weis, as an entity regulated, rather than

protected, by Section 17(a), has no claim thereunder for interference with its rights, and therefore neither does the Trustee as Weis' successor. Moreover, the common law doctrine does not permit a bailee who cannot satisfy an essential requirement for recovery (*e.g.*, membership in the special class which Section 17(a) benefits) to circumvent such a requirement by asserting that the bailor (*e.g.*, customers) could satisfy it.

Furthermore, any Section 17(a) right is completely outside the scope of the common law doctrine of bailment because it is not a right of action for interference with possession of tangible property, but is a right which is available only to a limited, special class for injury arising out of a relationship to which the statute provides special protection.

In any event, substantive federal securities laws principles preclude implication of any Section 17(a) private right on behalf of Weis (and the Trustee as its successor) as "bailee". A brokerage firm such as Weis, as a mere "bailee" of customer property, is not an intended beneficiary of Section 17(a). Nor is it *necessary* to imply a right of action under Section 17(a) in favor of such a bailee to protect its possessory interests (which are in any event adequately protected by State law), particularly where the bailee's own wrongdoing has led to its alleged injury.

Rule 17(a), F.R.Civ.P., also does not provide any basis for the Trustee to assert customer rights of action for violation of Section 17(a). Rule 17(a), which defines the procedural rights of a "real party in interest", merely provides procedural authority for the Trustee to assert whatever substantive rights he may have to sue as "bailee"—but the Trustee has no such substantive rights.

B. Not being entitled as a purported "bailee" to assert customer Section 17(a) rights, the Trustee is not otherwise entitled to assert those rights. Just as a bankruptcy or Chapter X trustee is not a proper party to assert rights of action belonging only to a particular class of creditors against a third party, *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), the Trustee is not a proper party to assert rights of action of the Weis customers (who are, of course, creditors of Weis to the extent that their claims against Weis are unsatisfied) against Touche Ross.

IV

A. Even if Section 17(a) did create an implied private right of action in brokerage firm customers against accountants, SIPC is not entitled to assert such an implied right as "subrogee" of Weis customers for the payment of whose claims SIPC advanced funds to the Trustee. SIPC's express statutory subrogation rights are set forth in Section 6(f)(1) of SIPA, which provides that SIPC, upon advancing funds for the payment of customer claims against the Weis estate, is subrogated only to those claims *against the estate.* The existence of the limited subrogation rights provided by Section 6(f)(1), in light of the comprehensive statutory scheme of SIPA and the doctrine *expressio unius est exclusio alterius,* means that those rights are exclusive and that SIPC is not subrogated to customers rights of action against third parties.

B. Moreover, SIPC has no equitable subrogation rights here. Once customers have been compensated by SIPC for their losses in accordance with SIPA, it is unnecessary, in order to effectuate the Congressional purpose of providing protection to customers, to imply a private right of action under Section 17(a) to recover those losses, either on behalf of the customers or on behalf of SIPC as subrogee. The only purpose of implying such a right of action and recognizing SIPC's subrogation thereto would be to benefit SIPC, not the customers. The result would be to transfer from SIPC (and brokerage firms

generally that are required to contribute to the "SIPC fund") to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress created SIPC in order to provide. Congress, by enacting SIPA and creating the "SIPC fund", imposed the risks of brokerage firm failure on the brokerage industry generally, thereby creating an incentive for SIPC and the industry to perform their responsibilities diligently. Shifting that risk from SIPC to accountants eliminates those incentives, thereby undermining the statutory purposes. Touche Ross will not be "unjustly enriched" should SIPC, and not Touche Ross, ultimately bear the burden of providing the protection to customers that SIPC was created by Congress in order to provide, and it is not "necessary" to shift that burden from SIPC to Touche Ross in order to effectuate Congress' goals.

In addition, Touche Ross—which will be required under common law principles to pay to the Weis estate any damages proximately caused by its negligence and malpractice—receives no "windfall benefit" even if SIPC (which is subrogated to customer claims against that estate) cannot sue here as subrogee. Furthermore, there is no Congressional intent that third parties such as Touche Ross be liable for the damages here sought, or that SIPC be permitted to recoup from third parties the funds it has advanced for customer claims.

ARGUMENT

I

In Light Of The Statutory Scheme Of The 1934 Act, Which Provides In Section 18(a) A Limited Express Remedy For Misstatements In Section 17(a) Reports, Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages For Such Misstatements, And The Court Of Appeals Majority Erred In Holding To The Contrary

As shown hereinafter, the pertinent statutory scheme includes Section 17(a) of the 1934 Act, which is one of the reporting provisions thereof and requires broker-dealers to file reports prescribed by the SEC, and Section 18(a), which provides to certain purchasers and sellers the only express private damage remedy for misstatements in Section 17(a) reports. However, neither the Trustee, nor SIPC, nor any Weis customer whose claims they purport to assert, is within the purchaser-seller class to which Section 18(a) provides a remedy, and the Trustee and SIPC do not even purport to sue thereunder. Instead, they proceed on the theory that Section 17(a) itself provides for them an implied private right of action for damages for misstatements in Section 17(a) reports—a theory which the Court of Appeals majority accepted to the extent of holding that Section 17(a) does create such an implied right of action for brokerage firm customers and that the Trustee (as a purported "bailee") and SIPC (as a purported "subrogee") may assert that implied right.

However, as also shown hereinafter, the statutory scheme— with its express and limited damage remedy in Section 18(a)—precludes the implication of any additional private right of action for damages from Section 17(a), and the Court of Appeals majority erred in holding to the contrary. As the Court of Appeals majority failed to

recognize, but as Judge Mulligan in dissent clearly understood, the presence of Section 18(a) in the statutory scheme means that

> (i) it is inappropriate to rely here upon the factors set forth in *Cort* v. *Ash*, 422 U.S. 66, 78 (1975), which were enumerated by this Court for determining "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added); and
>
> (ii) the controlling authorities are such decisions as *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("*Amtrak*"), and *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), which establish the principle that, absent clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided, and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), which recognizes that it is improper to imply broader remedies under the 1934 Act than the express statutory remedies specifically provided therein.

Moreover, even assuming that reliance upon a *Cort* v. *Ash* analysis were appropriate here, the Court of Appeals majority erred in its analysis of the applicable factors—including the "necessity" factor made a part of any such analysis by *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25-26 (1977). Furthermore, the Court of Appeals majority improperly relied upon *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). Finally, the Court of Appeals majority ignored the pertinent policy considerations which, to the extent that they may appropriately be considered, militate strongly against implying a right of action under Section 17(a).

A. The Pertinent Statutes And Rules: The Reporting Requirements Of Section 17(a) And Rule 17a-5, The Other Reporting Sections, And The Limited Express Private Right of Action Provided In Section 18(a) For Damages Resulting From Misstatements In Reports.

As this Court recently has emphasized in cases arising under the 1934 Act, "[t]he starting point in every case involving the construction of a statute is the language itself". *International Brotherhood of Teamsters* v. *Daniel*, —U.S.—, 47 U.S.L.W. 4135, 4136 (Jan. 16, 1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 24; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976); *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 756 (Powell, J., concurring). Here, the pertinent statutory language is found in the reporting provisions of Section 17(a), in the other reporting provisions of the 1934 Act, and in Section 18(a), and must be interpreted in light of the principle repeatedly emphasized by this Court that "'*the interdependence of the various sections of the securities laws* is certainly a relevant factor in any interpretation of the language Congress has chosen . . . .'" (emphasis added). *Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 206, *quoting Securities & Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969). *See also Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 727-730.

1. The Reporting Requirements Of Section 17(a) And Rule 17a-5.—Section 17(a), as in effect during 1972 when Touche Ross is alleged to have audited and certified the 1972 Weis financial reports, required broker-dealers such as Weis to "make such reports, as the [SEC] by its rules and regulations may prescribe". 15 U.S.C. §78q(a)

(1972).[13] Section 17(a) was implemented by SEC Rule 17a-5. 17 C.F.R. §240.17a-5 (1972). Rule 17a-5(a)(2) required that broker-dealers "file reports of financial condition containing the information required by Form X-17A-5 . . . within each calendar year". Rule 17a-5(c)(1) also provided that a broker-dealer "may file in lieu of the [Form X-17A-5] report required by [paragraph (a)] a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member".[14]

2. THE OTHER REPORTING PROVISIONS.—Section 17(a) is only one of the sections of the 1934 Act that require the filing of "reports" or similar material. Other such provisions are found in Sections 12(b)(1), 13(a), 13(d), 13(f) and 15(d). 15 U.S.C. §§78*l*(b)(1), 78m(a), 78m(d), 78m(f), 78o(d).[15] The reporting

[13] Section 17(a) as in effect in 1972 is set forth in the appendix annexed to this brief and provided as follows:

"(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section [15] of this [Act], shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. §78q(a) (1972).

Section 17(a) was substantially amended in 1975. *See* Securities Acts Amendments of 1975, Pub. L. No. 94-29, §14, 89 Stat. 137 (1975). However, even after the 1975 amendments, present Section 17(a)(1) contains essentially the provisions of the 1972 version from which the Court of Appeals majority derived its implied private right of action in favor of brokerage firm customers, *viz.*, the requirement that broker-dealers "make and disseminate such reports as the [SEC], by rule, prescribes". 15 U.S.C. §78q(a)(1).

[14] The 1972 version of Rule 17a-5 is set forth in full in the appendix annexed to this brief. Rule 17a-5, which also has been substantially amended since 1972, continues in Rule 17a-5(a)(2) to require filings by broker-dealers of Form X-17A-5 and to permit in Rule 17a-5(a)(4) the submission in lieu thereof of comparable data filed with a national securities exchange.

[15] Section 12(b)(1) requires every "issuer" of a security "registered on a national securities exchange" to file an "application

requirements of Section 17(a) and of the other sections of the 1934 Act and the rules implementing those sections are recognized to be interrelated, as shown, for example, by the express provision of Rule 17a-5(c)(2), as in effect in 1972, that in certain situations the SEC "will accept any statement of . . . financial condition filed pursuant to sections 13 or 15(d) of the [1934 Act] . . . and the rules and regulations promulgated thereunder as a filing pursuant to [Rule 17a-5]". Compare present Rule 17a-5(k), 17 C.F.R. 240.17a-5(k) (1977).

3. THE EXPRESS REMEDY IN SECTION 18(a) FOR REPORTING MISSTATEMENTS, INCLUDING MISSTATEMENTS IN SECTION 17(a) REPORTS.— The reporting provisions of the 1934 Act, including Section 17(a), do not themselves contain any express private remedy for misstatments in reports filed pursuant thereto. However, Section 18, 15 U.S.C. §78r, which is entitled "Liability for Misleading Statements", provides the express private remedy for such misstatements. That remedy is set forth in the carefully limited language of Section 18(a), and only permits certain *purchasers and sellers of securities* to recover damages, as follows:

"(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact,

[which] shall contain . . . [s]uch information" as the SEC may require. 15 U.S.C. §78*l*(b)(1). Section 13(a) requires every "issuer" of a registered security to file "such information and documents" and "such annual . . . and . . . quarterly reports" as the SEC may prescribe. 15 U.S.C. §78m(a). Section 13(d) requires any person becoming the beneficial owner of more than 5% of certain classes of equity securities to file "a statement containing such . . . information" as the SEC may prescribe. 15 U.S.C. §78m(d). Section 13(f) requires every "institutional investment manager" to file "reports" as the SEC may prescribe. 15 U.S.C. §78m(f). Section 15(d) requires certain issuers to file "supplementary and periodic information, documents, and reports" as may be required by Section 13. 15 U.S.C. §78o(d).

> shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading" (emphasis added). 15 U.S.C. §78r(a).[16]

In providing a remedy for misstatements "in any . . . report, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder", Section 18(a) necessarily covers reports filed pursuant to any of the reporting provisions, including Section 17(a) and Rule 17a-5. It is impossible to read Section 18(a) as not applying to Section 17(a), in light of the inescapable fact that both sections use the very same word "report"—Section 17(a) in providing that broker-dealers shall "make . . . reports" and Section 18(a) in providing liability for misstatements in "any . . . report". The Court of Appeals majority (*e.g.*, A.201), Judge Mulligan in dissent (*e.g.*, A.211-A.212) and the District Court (A.178-A.179), all clearly understood that Section 18(a) does apply to Section 17(a) reports—an understanding also reflected in numerous other decisions[17] and in the legislative history of the 1934

[16] Section 18 was not amended in 1975, and is the same now as in 1972.

[17] For example, as noted by Judge Mulligan's dissent (A.215 n.5), the District Court has upheld a Section 18(a) claim against Touche Ross by a plaintiff bank which allegedly purchased securities of Weis in reliance upon the very Section 17(a) reports upon which the Trustee and SIPC here rely. *Exchange National Bank* v. *Touche Ross & Co.* (S.D.N.Y. 75 Civ. 916); *see Exchange National Bank* v. *Touche Ross & Co.*, 544 F.2d 1126, 1127-1128 (2d Cir. 1976). *See also, e.g., Cramer* v. *General Telephone & Electronics Corp.*, 582 F.2d 259, 269 (3d Cir. 1978) (citing Section 17(a) as "one of several statutory provisions requiring the filing of . . . documents, and reports with the [SEC]", and holding that "Section 18 . . . provides a civil remedy for damages resulting from . . . a misleading statement in a document or report filed with the SEC"), *petition for cert. filed*, 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853); *In re Penn Central*

Act.[18]

Securities Litigation, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972) ("Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act [including §17(a)]"), *decision as to Section 13(a) adhered to on reargument*, 357 F.Supp. 869 (E.D. Pa. 1973), *aff'd*, 494 F.2d 528, 539-540 (3d Cir. 1974) (Section 18(a) applies to "a false statement in a document filed under any other section"); *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975) (Section 18 applies to "a false or misleading statement in a document filed pursuant to the [1934 Act]"), *aff'd by oral opinion*, 538 F.2d 312 (2d Cir. 1976); *Meer* v. *United Brands Co.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,648 at 90,213 (S.D.N.Y. 1976) ("Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements"); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973) (citing Section 17(a) as "one of a number of provisions that require the filing of . . . reports" and holding that "[c]ivil liability for failure to comply with [all] these sections is provided in Section 18(a)").

[18] For example, Senator Fletcher, Chairman of the Senate Committee on Banking and Currency, in introducing the original bill (S. 2693) which led to the passage of the 1934 Act, submitted a digest which stated that "Section 17 [of the bill, which became Section 18 of the 1934 Act] imposes civil liability for false or misleading statements in *any of the reports* or records required under this act" (emphasis added). 78 CONG. REC. 2271 (1934). Moreover, Richard Whitney, President of the New York Stock Exchange, submitted to the Senate and House committees considering the bill a statement expressing the awareness that Section 18 would impose liability upon "persons transacting business in securities" (*i.e.*, upon broker-dealers required to file reports under Section 17(a)) for misstatements in such reports, as follows:

> "Section 17 of the bill [Section 18 of the 1934 Act] deals with the liability of any person who shall make or be responsible for making any statement in any report or document filed with the . . . Commission, which was 'in the light of circumstances under which it was made, false or misleading in respect of any matter sufficiently important to influence the judgment of an average investor' . . . . In view of the unlimited character of the information which the . . . Commission has the right to require exchanges and *persons transacting business in securities*, as well as all corporations listed on a national exchange, to file with it, it will be humanly impossible to determine what facts may, in retrospect, be deemed to be sufficiently important to influence the judgment of an average investor" (emphasis added). *See Hearings Before the Senate Comm. on Banking and Currency*, 73rd Cong. 2d Sess. 6638 (1934). *See also Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 226 (1934).

B. The Trustee And SIPC Cannot State A Claim For Relief Under Section 18(a) And Therefore Have No Federal Claims Unless Section 17(a) Provides An Implied Private Right Of Action For Damages.

As the Trustee and SIPC concede, and as both the District Court and the Court of Appeals recognized (A.178, A.200-A.201, A.215-A.216 (dissent)), neither the Trustee nor SIPC, nor Weis' customers whose claims they purport to assert here, can meet the purchaser-seller requirement of Section 18(a), and therefore the Trustee and SIPC cannot (and do not) assert any entitlement to the express remedy of Section 18(a), either in their own right or in the right of the customers. Consequently, in order to find some purported basis in the 1934 Act to "federalize" their essentially common law claims for accountants' negligence and malpractice, the Trustee and SIPC argue that an implied right of action which they may assert is created by Section 17(a) itself. That argument, as shown hereinafter, misconceives the statutory scheme and the controlling decisions, was erroneously accepted by the Court of Appeals majority, and was properly rejected by the District Court and by Judge Mulligan in dissent.

C. In Light Of The Statutory Scheme Of The 1934 Act, And The Express Remedy Provided By Section 18(a), Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages.

In considering whether Section 17(a) creates an implied right of action for damages, it is of overriding significance that Section 18(a) already provides an express private damage remedy for violations of Section 17(a). The analysis required in such circumstances by this Court's controlling decisions demonstrates that the existence of Section 18(a), with its carefully limited express remedy, precludes the implication of a separate, and broader, remedy from the provisions of Section 17(a)

itself, and that such implication would seriously distort the statutory scheme of the 1934 Act. It also shows that Judge Mulligan was correct when he stated in dissent that the "majority's holding . . . goes beyond statutory construction [and] amounts instead to judicial legislation" (A.216).

1. THE EXISTENCE OF SECTION 18(a) MEANS THAT RELIANCE UPON *Cort* v. *Ash* IS NOT APPROPRIATE HERE.—The Court of Appeals majority based its holding that Section 17(a) creates implied private rights of action in brokerage firm customers upon a purported consideration of the factors set forth in *Cort* v. *Ash, supra* (A.195-A.200). However, as Judge Mulligan noted in his dissent (A.210, A.212), the *Cort* v. *Ash* factors were enumerated by this Court for the purpose of determining "whether a private remedy is implicit in a statute *not expressly providing one*" (exphasis added). 422 U.S. at 78. *See also, e.g., Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25, 37 ("[W]e must consider whether §14(e), which is *entirely silent as to private remedies,* permits this Court to read into the statute a damages remedy . . . . [I]n *Cort* v. *Ash* . . . . the Court identified four factors as 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added)).

Therefore, in light of the express remedy already provided in Section 18(a) for misstatements in 17(a) reports, this case does not involve a situation where (as in *Cort* v. *Ash)* a remedy is sought to be implied for violation of a statute as to which no express private remedy whatsoever is provided.[19] It involves instead a statutory

[19] *Cf.* Section 206 of the Investment Advisers Act, 15 U.S.C. §80b-6, which is a statutory provision for which no express remedy whatsover is provided and is the provision involved in *Lewis* v. *Transamerica Corp.,* 575 F.2d 237 (9th Cir.), *cert. granted sub nom. Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis,* 99 S.Ct. 348 (1978) (No. 77-1645) (*see also* A.214 n.4).

scheme in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the sole private remedy (Section 18(a)) it thought necessary and appropriate for violations of that requirement.[20] Consequently, *Cort* v. *Ash* does not set forth the appropriate analysis here. Rather, it is this Court's decisions in *Amtrak, supra, Securities Investor Protection Corp.* v. *Barbour, supra,* and *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which deal directly with the question of implying remedies from statutes already containing express remedies, that set forth the appropriate analysis.

2. THE CONTROLLING DECISIONS HERE ARE *Amtrak, Barbour* AND *Blue Chip Stamps,* WHICH COMPEL THE CONCLUSIONS THAT CONGRESS INTENDED SECTION 18(a) TO PROVIDE THE EXCLUSIVE DAMAGE REMEDY FOR MISSTATEMENTS IN SECTION 17(a) REPORTS, AND THAT NO ADDITIONAL OR BROADER REMEDY MAY BE IMPLIED FROM SECTION 17(a) ITSELF.—The express, and carefully limited, damage remedy provided by Section 18(a) for misstatements in Section 17(a) reports necessarily reflects a Congressional intention that a damage remedy for such misstatements would be available only as provided in Section 18(a)—*i.e.,* where a person purchased or sold a security in reliance thereon—and that no other damage remedy for such misstatements (*e.g.,* a damage remedy for brokerage firm customers who neither purchased nor

[20] This Court has recognized the clear dichotomy between sections of the 1934 Act for which no express remedy whatsoever is provided, and sections of the 1934 Act for which Section 18(a) does provide an express remedy. *E.g., Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 24-25 ("Section 14(e) . . . makes no provision whatever for a private cause of action, such as those explicitly provided in other sections of the 1933 and 1934 Acts. *E.g.,* §§ . . . 18 . . . of the 1934 Act"); *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 730 (noting "the contrast between the provisions of Rule 10b-5 [with its lack of express remedy] and the numerous carefully drawn express civil remedies [including specifically Section 18 of the 1934 Act] provided in the Acts of both 1933 and 1934").

sold securities in reliance thereon) was intended or could be implied. As Judge Mulligan's dissent observes, "Section 18(a) follows upon the heels of section 17" and "[i]ts subject matter covers reports . . . filed pursuant to the [19]34 Act", and thus *"common sense would dictate* . . . that section 18(a) expressly provides *the sole private remedy which Congress intended* to be available for a violation of section 17(a) and the other reporting sections" (emphasis added) (A.211).

The "common sense" conclusion that Congress intended Section 18(a) to be the exclusive damage remedy for misstatements in Section 17(a) reports is also required, as Judge Mulligan further recognized (A.213-A.214), by decisions of this Court explicitly directing that, where a remedy is sought to be implied from a statutory provision for which a limited express remedy already is provided, the doctrine *expressio unius est exclusio alterius* is to be applied. For example, in *Amtrak, supra,* this Court held that no private right of action could be implied under the Amtrak Act in favor of railroad passengers because Section 307(a) thereof granted an express remedy only to a limited class of persons (*viz.,* the Attorney General and certain railroad employees) that did not include such passengers, and because the implication of a private right in favor of other persons therefore would be inconsistent with the statutory scheme. Noting the compelling force of the *expressio unius* doctrine, the Court unequivocally directed that

> "*when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies.* 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.*

> Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created in §307(a) are the exclusive means to enforce the duties and obligations imposed by the Act" (emphasis added). 414 U.S. at 458.

Similarly, in *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 419, in holding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under SIPA precluded any implied right in others to seek similar relief, this Court reiterated the "observation [in *Amtrak*] that express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature".

The *expressio unius* doctrine that this Court found compelling in *Amtrak* and *Barbour* is equally compelling here to require a holding that, in light of the limited express remedy in Section 18(a), Section 17(a) itself creates no additional implied private right of action. To paraphrase the language of *Amtrak,* "[s]ince the [1934] Act creates . . . a private cause of action only under very limited circumstances [*i.e.,* the circumstances set forth in Section 18(a)], this maxim [*expressio unius est exclusio alterius*] would clearly compel the conclusion that the remedies created in [Section 18(a)] are the exclusive means to enforce the [reporting] duties and obligations imposed by [Section 17(a) and the other reporting provisions]". *See* 414 U.S. at 458.

While this Court did state in *Amtrak* that the *expressio unius* doctrine must "yield to clear contrary evidence of legislative intent", it then went on to examine the pertinent legislative history and to conclude that there was "no [such] contrary indication in any of the hearings or committee reports". 414 U.S. at 458, 461.[21] The same conclusion is unavoidable here because, as shown hereinafter (pp. 46-47, *infra*), the legislative history of the 1934 Act does not contain the "clear contrary evidence of legislative intent" to create an implied Section 17(a) remedy that *Amtrak* held to be necessary to overcome the application of the *expressio unius* doctrine otherwise required by the existence of Section 18(a). Indeed, even the Court of Appeals majority conceded that there is "no indication, either in the statute itself or in its legislative history, of any congressional intent . . . to create a private remedy under section 17", and stated that "[t]he legislative history of the section is mute on the issue" (A.198; *see also* A.214 (dissent); A.178 (District Court)). Consequently, *Amtrak* and *Barbour* require a holding that, in light of the existence of the express remedy in Section 18(a), Section 17(a) does not create any additional implied remedy.

Moreover, the implication under Section 17(a) of an implied right of action in addition to—and necessarily broader (in that it is not limited by the purchaser-seller requirement) than—the express remedy of Section 18(a) also directly conflicts with *Blue Chip Stamps* v. *Manor Drug Stores, supra,* where this Court emphasized the impropriety of implying a broader remedy for violations of the 1934 Act than the statutory remedies already expressly provided therefor.[22] In *Blue Chip Stamps,* in

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[21] *Cf. Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 201 ("mindful that the language of a statute controls when sufficiently clear in its context . . . further inquiry [*i.e.,* into legislative history] may be unnecessary").

[22] As the District Court here noted, the Trustee and SIPC "are obliged to argue that there is an implied private claim under Section 17 [not limited by the purchaser-seller requirement and therefore] *broader* than the claim *expressly* created by Section 18 . . . because they did not purchase nor sell any security . . . and thus cannot state a claim under Section 18" (A.178).

upholding the purchaser-seller requirement for claims under Section 10(b) of the 1934 Act and Rule 10b-5, this Court noted that "[t]he principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of §10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities", and then, specifically addressing itself to Section 18(a) of the 1934 Act, stated that

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . .' *It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action"* (emphasis added). 421 U.S. at 735-736.

Of course, what *Blue Chip Stamps* found "anomalous" was any imputed Congressional intent to permit a remedy for the "judicially implied cause of action" for violation of Section 10(b) and Rule 10b-5 that would be more broadly applicable (*i.e.,* not limited by the purchaser-seller requirement) than the remedies actually specified in "comparable express causes of action" in provisions such as Section 18 (which are expressly limited by the purchaser-seller requirement). However, as Judge Mulligan's dissent notes (A.215), the "anomalous" intention that *Blue Chip Stamps* said could not properly be imputed to Congress "is precisely what the majority is imputing to Congress in this case" by its holding that there is an implied right of action under Section 17(a) broader than (*i.e.,* in favor of brokerage firm customers who do not meet the purchaser-seller requirement of) the express

remedy under Section 18(a). Indeed, to imply a right of action under Section 17(a) broader than the express remedy under Section 18(a) is even *more* "anomalous" than to imply such a broader right under Section 10(b), because the express Section 18(a) remedy deals with circumstances that are, instead of being simply "comparable" to those dealt with by any remedy arguably to be implied from Section 17(a), *precisely the same* circumstances, *viz.,* misstatements in Section 17(a) reports.

Significantly, *Blue Chips Stamps* also emphasized—in finding, on the basis of the "[a]vailable evidence from the texts of the 1933 and 1934 Acts as to the Congressional scheme", a predominant pattern to grant private remedies to those damaged in the purchase or sale of securities (citing Sections 11(a) and 12 of the 1933 Act and Sections 9(e) and 18(a) of the 1934 Act), 421 U.S. 733-736—that "[w]hen Congress wished [in contrast to that pattern] to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly" (citing Section 16(b) of the 1934 Act; *see also* Section 20, 15 U.S.C. §78t, imposing liability on "controlling persons"), 421 U.S. at 734. As Judge Mulligan noted in dissent, the fact that Congress "had little trouble" in expressly providing any desired remedies to non-purchasers or non-sellers "reinforces the conclusion that *the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation* on the class for whom a private action would be available in the event of a Section 17(a) violation" (emphasis added) (A.214-A.215).

* * *

Thus, *Amtrak, Barbour* and *Blue Chip Stamps* are the controlling authorities and compel a contrary result to that

reached by the Court of Appeals majority. As aptly summed up by Judge Mulligan in dissent,

> "*Amtrak, Barbour* and *Blue Chip* compel the conclusion that the omission [of a remedy for misstatements in Section 17(a) reports in favor of brokerage firm customers] was studied and that the implication of a damage action against accountants under this section is totally unwarranted. *The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided [in Section 18(a)] was designed to exclude the class which is here seeking monetary relief*" (emphasis added) (A.215-A.216).

3. THE LEGISLATIVE HISTORY OF SECTION 17(a) DOES NOT SUPPORT AN IMPLIED RIGHT OF ACTION THEREUNDER.—As already noted (pp. 42-43, *supra*), and as recognized by the Court of Appeals majority (A.198), the pertinent legislative history simply does not contain any evidence whatsoever that Congress intended that Section 17(a) create any implied private right of action. It also contains no evidence that Congress intended that Section 18(a) be other than the exclusive remedy for violations of Section 17(a).[23]

The Congressional reports with respect to the bills that became the 1934 Act make no mention of a private right of action under Section 17 and refer only to administrative enforcement by the SEC. *See* S. REP. NO. 792, 73rd Cong., 2d Sess. 21 (1934); H.R. REP. NO. 1383, 73rd Cong., 2d Sess. 25 (1934); S. DOC. NO. 185, 73rd Cong.,

[23] *Cf. In re Penn Central Securities Litigation*, 494 F.2d 528, 540 (3d Cir. 1974) ("[w]e have not been cited to any language or to any history in the 1934 Act which indicates that Congress intended to extend the protection offered by §13(a) beyond the class of purchasers or sellers [referred to in Section 18(a)]").

2d Sess. 17 (Conf. Rep.) (1934). Commissioner Landis described Section 17 (Section 16 of the bill) as a provision that "puts the accounting of members of the exchanges, dealing in over-the-counter markets, [and] brokers who deal with members of the exchange under the control of the [SEC]", but no one involved in the committee hearings suggested that there could be any private right of action thereunder. *Hearings on H. R. 7852 and H. R. 8720 Before the House Comm. on Interstate and Foreign Commerce ("Stock Exchange Regulations")*, 73rd Cong., 2d Sess. 22, 225-226, 262, 536, 666, 670, 750, 804 (1934). Although criticism of Section 17 centered on the expense of administrative enforcement by the SEC, *see, e.g., id.* at 226, 536, 666, at no time was it proposed that the expense of public enforcement could be alleviated by permitting private suits under Section 17.

Thus, there is lacking here the "clear contrary evidence of legislative intent" which, under *Amtrak*, is necessary to overcome the presumption that the express remedy in Section 18(a) was intended by Congress to be the exclusive remedy for misstatements in Section 17(a) reports.[24] Such a presumption is particularly appropriate here because, while there is a total lack of any legislative history showing a Congressional intention to create in Section 17(a) an implied private right of action, the legislative history does reflect a Congressional understanding that the express Section 18(a) remedy was to apply to misstatements in Section 17(a) reports (*see* p. 37 n.18, *supra*).

[24] Even with respect to the 1975 amendments to the 1934 Act, which came during a period when a number of brokerage firms had collapsed, their customers had suffered damages as a result, and SIPC had been required to advance substantial funds for the payment of their claims, there was no suggestion in the legislative history that any private damage remedies were or should be provided for such customers. That legislative history is detailed in the brief *amicus curiae* (at 11-13) of the American Institute of Certified Public Accountants.

4. THE IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD BE CONTRARY TO THE PURPOSES OF THE PURCHASER-SELLER REQUIREMENT OF SECTION 18(a), AND IS NOT REQUIRED BY ANY "FLEXIBLE" CONSTRUCTION OR "REMEDIAL" PURPOSE OF THE 1934 ACT—*Blue Chip Stamps* recognized that an important purpose of the purchaser-seller requirement in Section 18(a), and in the other sections providing remedies to purchasers and sellers, is to require a direct and readily demonstrable connection between an alleged statutory violation and the plaintiff's alleged injury, and to exclude claims where that connection is speculative or incapable of being concretely demonstrated. Noting the SEC's own observation "that the effect, if any, of a deceptive practice on someone who has neither purchased nor sold securities may be more difficult to demonstrate than is the effect on a purchaser or seller", *Blue Chip Stamps* emphasized the speculative and unreliable nature of the proof that would be permissible if the purchaser-seller requirement were eliminated and a non-purchaser or non-seller were allowed to assert what might have been or what could have occurred but for the defendant's violation. 421 U.S. at 742-746.

The purported Section 17(a) claims of the Weis customers, which the Court of Appeals majority would permit the Trustee and SIPC to assert here, are exactly the kind of speculative and unreliable claims that *Blue Chip Stamps* held are, and should be, excluded by the purchaser-seller requirement. The claims of the Weis customers—who number "over 34,000" (A.25-A.31 [¶¶ 52, 55, 56, 62, 67, 71, 74, 75, 79, 82, 83]) — are not based upon injury suffered as part of an "objectively demonstrable" purchase or sale of securities, but rather upon alleged damages suffered as the result of inaction by the SEC, SIPC, the Exchange, Weis, its Board of Directors and the

customers. According to the Trustee and SIPC, the customers were injured, and Touche Ross is obligated to make good their injuries, because they left property at Weis, because Weis collapsed and because, but for the misstatements in the Weis financial statements,

> "Weis' 1973 forced liquidation under [SIPA] *would not have* become necessary, and most if not all of Weis' assets and its good will as a going concern *could have been* preserved by a number of means . . . . Moreover, *if* a liquidation of Weis *had been necessary* as the result of . . . truthful reporting, such liquidation *could have occurred* at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later" (emphasis added) (A.8-A.9 [¶11]).

In other words, the Trustee and SIPC here talk of what "would not have become necessary", what "could have been" and what "could have occurred", making clear that the customer claims they assert here are, just as the claims in *Blue Chip Stamps* were, based not upon actions that were in fact taken, but rather upon failures to take action and speculative allegations concerning what actions might have been taken and the consequences that might have resulted therefrom. Trial of such claims would hinge on speculative and subjective testimony and would raise precisely the problem that *Blue Chip Stamps* says must be avoided. *Cf. Abrahamson* v. *Fleschner,* 568 F.2d 862, 884 (2d Cir. 1977), *cert. denied,* 436 U.S. 913 (1978) ("the underlying concern in *Blue Chip,* though standing was involved, was . . . , perhaps, the sheer inability to disprove what a plaintiff says he *would have* done if he had but known the truth") (Gurfein, C.J., dissenting).[25]

[25] It is also significant that any injury here resulted directly from waste and mismanagement by Weis' officers of the assets held by Weis—waste and mismanagement which is expressly alleged to have

Thus, the salutary purpose of eliminating speculative and unreliable claims that led this Court in *Blue Chip Stamps* to uphold the purchaser-seller requirement for Section 10(b) actions also compels the conclusion that the Trustee and SIPC cannot be permitted to avoid the purchaser-seller requirement of Section 18(a) simply by asserting a purported implied right of action under Section 17(a).[26]

Moreover, the purchaser-seller requirement is not to be avoided by facile assertions about "flexible" construction or "remedial" purposes of the 1934 Act. *Blue Chip Stamps* expressly rejected the view that the purchaser-seller requirement is inconsistent with the principle that the provisions of the 1934 Act should be flexibly construed, and concluded that "[h]owever *flexibly* we may construe the language of both provisions, nothing in such construction militates against the [purchaser-seller] rule" (emphasis added). 421 U.S. at 749. And only last Term, in *Securities & Exchange Commission* v. *Sloan*, 436 U.S. 103, 115-116 (1978), this Court emphasized that reference to the generalized "remedial purposes" of the 1934 Act does not justify reading a particular provision "more broadly than its language and the statutory scheme reasonably permit", even assuming that a "totally satisfactory remedy" therefore would not be available "in every instance in which the [SEC] would like such a remedy". *See also Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 200 (rejecting argument "that the 'remedial purposes' of the Acts demand a construction of § 10(b) that embraces negligence as a standard of liability").[27]

5. NUMEROUS RECENT DECISIONS, INCLUDING TWO DECISIONS OF THE THIRD CIRCUIT, RECOGNIZE THAT THE FOREGOING PRINCIPLES PRECLUDE THE IMPLICATION OF PRIVATE RIGHTS OF ACTION UNDER REPORTING PROVISIONS SUCH AS SECTION 17(a).—Two recent Third Circuit decisions, as well as numerous district court decisions, hold that, in light of the foregoing principles and the statutory scheme that includes in Section 18(a) an express remedy for misstatements in reports required by other provisions of the 1934 Act, Section 18(a) is the exclusive remedy for such misstatements and no other remedies may be implied from the reporting provisions themselves. Those decisions—like Judge Mulligan's dissent here—recognize that implication of additional implied remedies from the reporting provisions themselves would ignore the intention of Congress and the controlling decisions of this Court, and would distort the statutory scheme.

occurred here (*e.g.*, A.20 [¶31h])—and at most resulted only indirectly or remotely from any misstatements in the 1972 Weis financial reports. This Court has recognized that the purchaser-seller requirement found in such provisions as Section 18(a) limits the class of persons who may bring private actions to those whose injuries (*viz.*, purchases of securities at prices inflated, or sales of securities at prices depressed, by misstatements) result directly and demonstrably from violations of the 1934 Act and not from waste and mismanagement allegedly made possible by such violations. *Cf. Santa Fe Industries, Inc.* v. *Green, supra*, 430 U.S. at 479 ("Congress . . . did not seek to regulate transactions which constitute no more than internal corporate mismanagement"); *Hoover* v. *Allen*, 241 F.Supp. 213, 225 (S.D.N.Y. 1965); *Bio-Medical Sciences, Inc.* v. *Weinstein*, 407 F.Supp. 970, 974 (S.D.N.Y. 1976).

[26] *Blue Chip Stamps* also referred to another, separate aspect of the "vexatious litigation" which would flow from elimination of the purchaser-seller requirement, *viz.*, that it would increase the incidence of claims which, although they had little objective chance of success, would permit undue use of the liberal federal discovery rules and taking up of others' time, and thereby would add an "*in terrorem* increment [to] the settlement value". 421 U.S. at 740-743.

[27] *See also Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.*, 417 U.S. 703, 717 n.13 (1974) ("[T]he statutory design [of the securities statutes] has not been effectuated through the indiscriminate provision of causes of action to every citizen. Rather, these statutes create specifically defined legal duties to particular plaintiffs and vest the appropriate causes of action in them alone").

For example, in *In re Penn Central Securities Litigation, supra,* plaintiffs alleged that reports filed under Section 13(a) of 1934 Act were misleading and asserted (because they were not purchasers or sellers of securities and thus did not fall within Section 18(a)) that they had an implied right of action for damages under Section 13(a) itself. The District Court dismissed the Section 13(a) claims. 347 F.Supp. 1327 (E.D. Pa. 1972), *decision as to Section 13(a) adhered to on reargument,* 357 F.Supp. 869 (E.D. Pa. 1973). It pointed out that

> "Section 13 is one of a number of provisions [of the 1934 Act] that require the filing of . . . reports. *See* §§ . . . 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act", 347 F.Supp. at 1340,

and then, although recognizing that "Courts have implied civil remedies for violations of [certain] provisions of the [1934 Act]", held that Section 18(a) "is the exclusive remedy for violation of § 13(a)" because

> "when the legislature has specifically authorized or withheld the right to recover damages arising by reason of a violation of a statute, an implied right of action does not exist. . . . Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover. . . . Given the express civil remedy for § 13(a) provided by § 18(a), we conclude that § 13(a) does not afford a private right of action", *id.* at 1339-1340.

The Third Circuit affirmed. 494 F.2d 528 (3d Cir. 1974). It emphasized that a contrary holding "would result in the elimination of the purchaser-seller requirement for violations of § 13(a)", and that "the same considerations

[which require application of the purchaser-seller requirement to section 10(b)] also apply to [require denial of] the contention . . . that we should imply a private right of action in section 13(a) to avoid the purchaser-seller requirement of section 18". *Id.* at 540-541.

More recently, in *Cramer* v. *General Telephone & Electronics Corp.,* 582 F.2d 259, 269 (3d Cir. 1978), *petition for cert. filed,* 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853), the Third Circuit again upheld dismissal of a claim under Section 13(a) where the plaintiff was unable to satisfy the requirements of Section 18, noting that

> "Section 13 is one of several statutory provisions requiring the filing of applications, documents, and reports with the [SEC]. *See also* §§ . . . 17(a) of the Act. . . . Section 18, 15 U.S.C. § 78r, provides a civil remedy for damages resulting from the purchase or sale of a security in reliance upon a misleading statement in a document or report filed with the SEC."

The reasoning and holding of the Third Circuit decisions, and of the numerous district court decisions reaching the same result,[28] are clearly applicable to Sec-

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[28] *See, e.g., Cramer* v. *General Telephone & Electronics,* 443 F.Supp. 516 (E.D. Pa. 1977) (Section 12(b)(1)), *aff'd,* 582 F.2d 259 (3d Cir. 1978), *petition for cert. filed,* 47 U.S.L.W. 3392 (Nov. 27, 1978) (No. 78-853); *DeWitt* v. *American Stock Transfer Co.,* 433 F.Supp. 994, 1004-1005 (S.D.N.Y.) (Sections 13(a) and 15(d)), *modified on other grounds,* 440 F.Supp. 1084 (S.D.N.Y. 1977); *Levy* v. *Johnson,* [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,899 at 91,324 (S.D.N.Y. 1977) (Section 13(a)); *Lewis* v. *Elam,* [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,013 (S.D.N.Y. 1977) (Section 13(a)); *Meer* v. *United Brands Co.,* [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,648 (S.D.N.Y. 1976) (Section 13(a)); *In re Equity Funding Corp. of America Securities Litigation,* 416 F.Supp. 161, 190 (C.D. Cal. 1976) (Section 13(a)); *McLaughlin* v. *Campbell,* 410 F.Supp. 1321, 1325 (D. Mass. 1976) (Section 13(a)); *Myers* v. *American Leisure Time Enterprises, Inc.,* 402 F.Supp. 213 (S.D.N.Y. 1975), *aff'd by oral opinion,* 538

tion 17(a). Section 17(a), like the sections of the 1934 Act involved in those decisions, is a reporting provision, and Section 18(a) is as applicable to misstatements in Section 17(a) reports as it is to reports filed under those other sections.

6. THE COURT OF APPEALS ERRED BECAUSE IT MISAPPREHENDED THE STATUTORY SCHEME, AND BECAUSE IT FAILED TO APPLY THE ANALYSIS REQUIRED BY, AND THEREFORE REACHED A RESULT IN CONFLICT WITH, THIS COURT'S CONTROLLING DECISIONS.—In failing to conclude (as have the other courts to consider the issue) that Section 18(a) provides the exclusive remedy for reporting violations, and in holding that Section 17(a) creates an implied private right of action despite the express Section 18(a) remedy, the Court of Appeals majority misapprehended the statutory scheme of the 1934 Act. Its basic error was its reliance upon the factors held relevant in *Cort* v. *Ash* for "determining whether a private remedy is implicit in a statute *not expressly providing one*", and its consequent failure to apply the analysis required by *Amtrak, Barbour* and *Blue Chip Stamps* to this case, where there already exists an express remedy (Section 18(a)) for violations of the statutory provision (Section 17(a))

F.2d 312 (2d Cir. 1976) (Section 13(d)); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973) (Section 13(a)). There are a few cases which, without analysis, would appear to hold to the contrary and permit a private right of action under one of the provisions of Section 13. In rejecting those cases as meaningful authority, the Third Circuit in *In re Penn Central Securities Litigation, supra*, cited them and described their defects as follows:

> "In re Caesar's Palace Securities Litigation, 360 F.Supp. 366, 388 (S.D.N.Y. 1973) (denying motion to dismiss § 13 claims without discussion of this issue); . . . Kaminsky v. Abrams, 281 F.Supp. 501, 505 (S.D.N.Y. 1968) (accepting possibility of private action under § 13) (dicta); Kroese v. Crawford, '61-'64 CCH Fed.Sec.L. Rep. ¶91,262 (S.D.N.Y. 1963) (denial of motion to dismiss under § 13(a), upholding private right of action, based on unexplicated 'history and purposes of the federal securities laws.')". 494 F.2d at 540 n. 18.

under which an implied remedy is sought. That analysis first requires recognition of the existence of the express remedy of Section 18(a), then consideration of Sections 17(a) and 18(a) in light of the *expressio unius* doctrine and in light of the anomaly of implying a Section 17(a) remedy broader than the express Section 18(a) remedy, and finally application of those considerations to bar an implied remedy under Section 17(a) in the conceded absence of "clear contrary evidence of legislative intent".

However, the Court of Appeals majority instead purported first to analyze Section 17(a), and to determine whether it creates an implied remedy, *without any consideration of Section 18(a)* (A.195-A.200). Only after concluding that there is such an implied remedy did the majority finally give cursory consideration to Section 18(a), and then only to assert that it does not detract from the existence of such a remedy (A.200-A.201). Of course, as *Amtrak, Barbour* and *Blue Chip Stamps* make clear, that approach is based upon the patently erroneous view that Section 18(a) is in no way indicative of the Congressional intent as to whether Section 17(a) creates an implied remedy—a view which the majority acknowledged holding by its statement that "[w]e find no indication . . . *in the statute itself* . . . of any congressional intent either to create a private remedy under Section 17 or to deny one" (emphasis added) (A. 198).

The erroneous failure of the Court of Appeals majority to give proper weight to Section 18(a) resulted from its equally erroneous conclusion that Section 18(a) is irrelevant here because brokerage firm customers are "members of a class peculiarly protected by Section 17" and "are favored wards of Section 17", because the express remedy of Section 18(a) will normally not be available to such customers, and because "[w]e cannot agree that Congress simultaneously sought to protect a class and

deprived the class of the means of protection" (A.196, A.200). In the first place, the Court of Appeals majority clearly overstated in asserting that brokerage firm customers would be "deprived . . . of the means of protection" (A.200) without an implied right of action under Section 17(a). As Judge Mulligan's dissent spells out in detail (A.216-A.221; *see also* pp. 60-63, *infra*), brokerage firm customers have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), both as part of the monitoring system and as a source of funds to pay customer losses, the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies.

The unavailability of the express Section 18(a) remedy for misstatements in Section 17(a) reports to persons (such as brokerage firm customers) who do not meet the purchaser-seller requirement, but who conceivably might be injured as a result (albeit not a direct and readily demonstrable one — *see* pp. 48-50, *supra*) of such misstatements simply reflects a Congressional intention that no *federal* damage remedy be available to them, and is consistent with the fact that the 1934 Act was never intended to provide a *federal* damage remedy for every conceivable dereliction.[29] Such persons still have their State court remedies, as the Trustee, SIPC and the Weis customers well understand in maintaining their State court

[29] *Cf. Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970) ("That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. The remedy in many cases may be found in the state courts. . . . If there is to be a federal remedy, it is the Congress which must create it"), *cited with approval in Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 738-739 n.9. *See also* 78 CONG. REC. 2270 (1934) (remarks of Senator Fletcher, sponsor of Senate bill S.2693, which eventually became the 1934 Act).

actions on the basis of allegations identical to those asserted here (*see* pp. 6-7, 16 n.12, *supra*),[30] and it would impermissibly conflict with the clear statutory scheme to disregard the requirements of Section 18(a) in order to permit them also to sue in the federal courts.

Thus, the real issue here is not whether to grant the customers a Section 17(a) implied remedy or else to leave them without any protection, but rather whether to add to the protections they already have the additional protection of a Section 17(a) implied remedy that Congress itself intentionally refused to provide.

Moreover, the conclusion of the Court of Appeals majority that Section 18(a) is irrelevant simply does not follow from its premises that Section 17(a) protects brokerage firm customers and that Section 18(a), because it protects purchasers and sellers only, would not normally be available to them. Even if those premises were assumed to be correct, and even if it be assumed that the Court of Appeals were correct in also postulating that "protection of [brokers' customers] is wholly independent" from Section 18(a) (A.201), the existence of Section 18(a) nevertheless necessarily demonstrates a Congressional intention that the purchasers and sellers referred to therein be the only class with a damage remedy for misstatements in Section 17(a) reports. If, in enacting the 1934 Act, Congress was as aware of, and consciously concerned with protecting, both brokerage firm customers (its "favored wards" in Section 17(a), according to the majority) and purchasers and sellers (to whom it pro-

[30] *Cf. Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 738-739 n.9 (observing that any disadvantages of the purchaser-seller rule are "attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law", that redress for the conduct alleged in the *Birnbaum* case ultimately was obtained "in a cause of action based on state law", and that plaintiffs in *Blue Chip Stamps* had commenced a parallel state court action).

vided the express damage remedy in Section 18(a)), the withholding of an express damage remedy from the customers, while at the same time giving such a remedy to the purchasers and sellers, can only mean that Congress consciously intended that the customers not have a damage remedy and that their protection be provided in a different way. As Judge Mulligan's dissent correctly puts it,

> "if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers" (A. 212).[31]

D. The Necessity Standard Of *Piper* Bars Implication Of A Private Right of Action Under Section 17(a).

In *Piper* v. *Chris-Craft Industries, Inc., supra,* this Court held that private rights of action for damages under the 1934 Act are not to be implied unless "*necessary* to effectuate Congress' goals", and pointed out that such a "necessity" standard goes as far back as its 1964 decision in *J. I. Case Co.* v. *Borak* (where it was "necessary" to

[31] Significantly, Section 18 is entitled "Liability for Misleading Statements" (instead of, for example, "Rights of Purchasers-Sellers"), thereby plainly demonstrating that the Congressional intention in Section 18(a) was not simply to grant a remedy to purchasers and sellers, but to delineate the full scope of liability for misleading statements in filed reports by providing that purchasers and sellers were the only class to which a remedy for such statements was to be available. *Cf. Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 734 ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly").

imply such a right of action under Section 14(a) of the 1934 Act in order to achieve its purposes) (emphasis added). 430 U.S. at 25-26.[32] *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477; *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 62-63 (1975). The District Court here properly recognized that no private right of action could be implied under Section 17(a) unless it met the "necessity" test of *Piper,* and carefully pointed out that "[t]his test has . . . been applied here and no such implication found 'necessary'" (A.182-A.183). Similarly, Judge Mulligan in dissent, after extensive discussion of the pertinent factors (A.216-A.222), correctly concluded that "there is no showing here that a private damage remedy [under Section 17(a)] against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a)" (A.222). On the other hand, as Judge Mulligan pointed out, the Court of Appeals majority "fail[ed] to consider the impact" of *Piper* and its necessity standard (A.216).

1. Implication Of A Private Right Of Action Under Section 17(a) Is Not "Necessary".—Proper analysis demonstrates that, as Judge Mulligan and the District Court found, implication of a private right of action is not "necessary" to effectuate the Congressional purposes underlying Section 17(a). It is to be emphasized that, in making the analysis, and as made clear in *Piper,* it is improper to imply a private damage remedy where the

[32] As Judge Mulligan noted in his dissent, "[t]he underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied" (A.216 n.6). Judge Mulligan also pointed out that, since *Piper* involved Section 14(e) of the 1934 Act, for which no express remedy whatsoever was provided, and therefore presented a *Cort* v. *Ash* situation, the Court's emphasis on the necessity factor means that "*Piper* . . . is not simply a restatement or affirmation of *Cort* but adds a significant gloss" (A.216 and n.6, A.222).

only reason is that such a remedy would accord, or be consistent, with a general statutory purpose, and that such a remedy can be regarded as "necessary" only "where *congressional purposes are likely to be undermined* absent private enforcement" (emphasis added). 430 U.S. at 25. *See also Lank* v. *New York Stock Exchange,* 548 F.2d 61, 65 (2d Cir. 1977) ("[e]ven were we to agree with [plaintiff] that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place").[33]

Moreover, it is also important that the creation of a damage remedy is not made "necessary" simply because it would impose an added damage penalty on the alleged wrongdoer. As *Piper* makes explicit, an "ever-present threat of damages" is not in and of itself *necessary,* because "[t]he deterrent value, if any" of a private right of action is so speculative that it does not "provide significant additional protection". 430 U.S. at 39-40. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co.,* 417 U.S. 703, 717 (1974) (deterrence of wrongful conduct is not in itself a sufficient ground to permit any plaintiff to recover); *Fridrich* v. *Bradford,* 542 F.2d 307, 321 (6th Cir. 1976), *cert. denied,* 429 U.S. 1053 (1977).

The Congressional purpose in providing for the scheme by which brokerage firms are regulated and of which Section 17(a) is an integral part was to provide a reporting and monitoring system which would help prevent brokerage firm insolvencies. Thus, the preventive monitoring of brokerage firms by the SEC, the Exchange and SIPC under the regulatory scheme—a scheme which

[33] The Court of Appeals majority therefore does not advance its argument by asserting that "a private right of action under Section 17 is *consistent* with [the legislative] purposes" (emphasis added) (A.199).

includes as an important element the net capital rule and the requirement that Section 17(a) reports contain data necessary to determine compliance with that rule[34]—is extensive.[35] The SEC has available to it investigative, criminal and injunctive proceedings to enforce compliance with, and to deter violations of, the regulatory requirements. *See, e.g.,* 15 U.S.C. §78u; *United States* v. *Sloan,* 389 F.Supp. 526 (S.D.N.Y. 1975); *Securities & Exchange Commission* v. *Resch-Cassin & Co., Inc.,* 362 F.Supp. 964, 979 (S.D.N.Y. 1973).[36] Since 1970, when SIPA was enacted, the regulatory scheme has included SIPC, with not only the function of participating in the preventive monitoring of the brokerage firms and seeking liquidation of such a firm where necessary, but also with the function of ensuring that brokerage firm customers are protected

[34] The Court of Appeals majority pointed out that "[o]ne of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325", and that "[i]t is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule" (A. 197-A. 198). The majority also pointed out that "[t]he net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its 'principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers.' Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶72,129 (1967)" (A.197; *see also* A. 217 (dissent)).

[35] For example, the SEC itself, in its brief *amicus curiae* (at 25-26 n.37) submitted to the Court of Appeals, conceded that its "broker-dealer inspection program is an extensive one". The SEC examines "[e]ach of the approximately 750 broker-dealers who are not members of self-regulatory organizations . . . every year for compliance with Commission regulations", as well as "roughly 5 percent" of those belonging to self-regulatory organizations and "about 500" each year "for 'cause' (usually as a result of a complaint received)". Under certain circumstances, "much closer scrutiny is provided by the Commission". *Id.*

[36] As already noted herein (pp. 5-6, *supra*), and as pointed out by Judge Mulligan (A.219 n.8), injunctive and criminal sanctions were obtained in the Weis situation against Weis and the Weis Five.

against loss by providing funds to pay customer losses.[37] And, of course, there are available to such customers the usual state law remedies, including common law actions for damages against accountants. *See, e.g., White* v. *Guarente,* 43 N.Y.2d 356, 372 N.E.2d 315 (1977); RESTATEMENT (SECOND) OF TORTS §552 (1977).

In view of the foregoing, Judge Mulligan was clearly correct in concluding that "the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers[,] not to create private law suits for damages *after* insolvency has occurred" (A.219).[38] Judge Mulligan also

[37] The enactment of SIPA, and its creation of SIPC to provide funds to pay customer losses, reflects a Congressional understanding that no federally-created remedy (*e.g.,* an implied private right of action for damages under Section 17(a)) was available to compensate against such losses, and that—to the extent that it considered existing remedies for customers to be inadequate—it was enacting SIPA and creating SIPC to fill that void by providing whatever additional protection for customers it believed necessary. *Cf. International Brotherhood of Teamsters* v. *Daniel, supra,* 47 U.S.L.W. at 4139 ("The existence of this comprehensive legislation [ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. *Congress believed that it was filling a regulatory void* when it enacted ERISA" (emphasis added)). *See also* p. 47 n.24, *supra* (1975 amendments to the 1934 Act). Significantly, the maximum amount that SIPC is required to advance for each customer was recently increased from $50,000 (of which not more than $20,000 could have been in respect of a claim for cash), *see* 15 U.S.C. § 78fff(f)(1) (1970), to $100,000 (of which not more than $40,000 may be in respect of a claim for cash), *see* 15 U.S.C.A. § 78fff-3(a) (Supp. V 1978). Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 9, 92 Stat. 260, 265 (1978).

[38] Judge Mulligan reached his conclusion because "the plain language of Section 17 establishes *the congressional concern that the SEC be kept on notice* of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities" (A.216); because "[t]he SEC itself has long recognized that the *primary protection for brokers' customers lies in preventive monitoring*" under a regulatory system which includes the "net capital rule" and which ensures "[c]ompliance by broker-dealers with the net capital rule . . . by *the filing of reports* [*by the broker-dealers*] *and monitoring by SEC as well as by the Exchange*" (A.217); and because of the enactment in 1970 of SIPA and the creation therein of SIPC,

correctly found that the "importance to this scheme of implying a damage remedy [under Section 17(a)] *after* liquidation [of a brokerage firm] is dubious", and that in any event the implication of such a remedy is not *necessary* to effectuate the Congressional goals (A.219-A.221). In the 45 years since enactment of the 1934 Act the regulatory scheme has operated without a single court other than the Court of Appeals majority here finding it appropriate—let alone "necessary"—to imply a private right of action for damages under Section 17(a). Moreover, as the District Court noted, "criminal prosecutions and SEC injunctions seem abundantly sufficient" to enforce, and to deter other violations of, the reporting requirements of Section 17(a) (A.182). As Judge Mulligan noted, "[t]he threat of liquidation under SIPA as well as the criminal sanctions available for violations of Section 17(a) certainly present a greater deterrent than private damage actions"; furthermore, ample "available state law remedies" arising from "well established tort law principles" also exist to deter misconduct by accountants (A.219-A.221). *Cf. Fridrich* v. *Bradford, supra,* 542 F.2d at 321-322.

In considering the necessity factor, it is also important not to confuse Section 17(a) with the prospectus provisions, the antifraud provisions and the proxy provisions. Those other provisions have a different basic purpose—*i.e.,* to insure that investors have available to them such data as Congress thought they would require in order adequately to proceed with their own investment and corporate voting activities—and the filing of such data with the SEC and other regulatory authorities is only incidental to its transmission to the investors, so that the SEC and other regulatory authorities can exercise "only an oversight or policing function" with respect thereto (A.181 (District Court)). Where that basic purpose exists, and

not only to "provid[e] protection to investors upon the liquidation of their brokers", but also to "*maintain . . . an early warning system* and *monitor . . . the affairs* of any [brokerage] firm that it is given reason to believe may be in danger of failure" (A.217-A.218) (emphasi added).

where investors are the primary recipients of data that is to influence their conduct in purchasing and selling securities or in corporate voting, and the SEC and the regulatory authorities have only an oversight role, private damage actions by such investors may be a necessary supplement to SEC action. However, as shown hereinabove and as recognized by Judge Mulligan and the District Court, the basic purpose of Section 17(a) is drastically different. The SEC and other regulatory agencies are the primary recipients of the information required thereby, and the basic purpose of the reports is to permit the SEC and other regulatory authorities to monitor brokerage firms, not to provide to investors data for their investment decisions. Investors are affected not as a direct result of their own decisions in reliance on the pertinent data, but only consequentially by the overall success or failure of the regulatory authorities in achieving their objectives.[39] In that context, it is *unnecessary* to imply a private damage remedy under Section 17(a) in order to effectuate the Congressional purposes of, and the failure to imply such a remedy will not "undermine", the regulatory scheme.

2. THE COURT OF APPEALS MAJORITY ERRED IN CONCLUDING THAT AN IMPLIED RIGHT OF ACTION IS "NECESSARY". — None of the reasons advanced by the Court of Appeals majority to support implication of a private right of action under Section 17(a) satisfies the *necessity* requirement of *Piper.* For example, the majority's conclusion, purportedly premised upon *J. I. Case Co.* v. *Borak, supra,* that "a private remedy is an essential supplement to the scheme of enforcement of section 17" because the SEC "does not have the resources to examine

[39] Of course, information supplied to the regulatory authorities in Section 17(a) reports may well find its way into the hands of investors and be used by them in making investment decisions, *i.e.*, decisions to purchase or sell securities. In such situations, Section 18(a) provides an express remedy to the investors for damages caused by their reliance upon misstatements in the Section 17(a) reports.

and audit all the documents that it receives" (A.199, A.200) simply is unacceptable. While the majority appears to have belittled the activities of the SEC in examining financial reports of brokerage firms (A.199 n.12), the SEC itself admits that its monitoring activities are extensive (*see* p. 61 n.35, *supra*), and Congress regards those activities as an important part of the regulatory scheme of which Section 17(a) is a part. *See* S. REP. NO. 94-75, 94th Cong., 1st Sess. 120, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 297 ("Examination authority, contained in present Section 17(a) is, of course, essential to any effort by the Commission to discharge its responsibilities under the Act"). Moreover, even if it be assumed that there are practical limitations on the SEC's ability to perform examinations,[40] such limitations themselves are insufficient to require implication of a private right of action under Section 17(a), particularly in light of this Court's admonition in *Piper* that "[e]ven though the SEC operates in this context under the same practical restraints recognized by the Court in *Borak,* institutional limitations alone do not lead to the conclusion that any party interested . . . should have a cause of action for damages". 430 U.S. at 41. As Judge Mulligan's dissent points out, "[t]he argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive" (A.221).

Similarly unacceptable is the majority's reliance upon an asserted need for nationally uniform standards for

[40] In fact, as Judge Mulligan's dissent pointed out, the problem referred to in *J. I. Case Co.* v. *Borak, supra,* with respect to the SEC's ability to examine proxy statements under demanding time limitations, is not encountered with respect to its examination of Section 17(a) reports, and the SEC's burden also is lightened by examinations that are performed by the Exchange of net capital statements of its members (A.221 n.11, *see also* A.181-A.182 (District Court)).

actions brought to recover losses after a brokerage firm has failed (A.200). Since the *primary* legislative purpose in enacting Section 17(a) was to provide a system of reports and monitoring to *prevent* insolvency, providing uniform standards for recovery of losses resulting from liquidation would not, and is not *necessary* in order to, achieve that purpose, even if it be assumed that the majority was correct in asserting that "state law protection of brokers' customers varies widely" (*id*; *but see* A.219-A.220 (dissent)). This Court recently has restated the principle that where state law remedies traditionally have been available federal courts should be reluctant to intrude federal remedies into the area to serve " 'at best a subsidiary purpose' of the federal legislation", *Sante Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478, and has recognized that relegation of plaintiffs to such state law remedies is appropriate, *e.g., id.* at 478 (state law appraisal remedy); *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 40-41 (common law tort remedy).

Finally, in light of the foregoing, the observation by the Court of Appeals majority that "[n]either SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost" (A. 199) is not relevant. The purpose of Section 17(a) is not compensatory, and the absence of a federal damage scheme for violations thus will not frustrate or undermine the statutory purpose.

E. Even If *Cort* v. *Ash* Did Provide The Applicable Analysis Here, It Does Not Permit Implication Of A Private Right of Action Under Section 17(a).

As already shown, the Court of Appeals majority erred in relying upon a *Cort* v. *Ash* analysis in light of its express limitation to "determining whether a private remedy is implicit in a statute not expressly providing one" (pp. 39-40, 54-55, *supra*), and because the majority did not properly take into account the "necessity" factor which *Piper* requires as a part of any such analysis (pp. 58-66, *supra*). However, even if the factors specifically identified in *Cort* v. *Ash* were assumed to be the only appropriate ones for consideration, they too require the conclusion that Section 17(a) creates no implied private right of action and that the Court of Appeals majority erred in holding to the contrary.

First, the existence of Section 18(a) shows that insofar as private rights of action for damages may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided,* even though the statute through its preventive monitoring scheme, as opposed to its scheme of private civil remedies, more generally also seeks to provide protection for brokerage firm customers. Second, the statutory scheme reflects *a legislative intent* to deny a remedy here. Section 18(a) provides an express private right of action for damages to purchasers and sellers of securities who rely in their securities transactions upon misleading reports filed under Section 17(a). That fact, combined with legislative history which shows no express intention to create a damage remedy for anyone other than purchasers and sellers, evidences a Congressional intention to restrict causes of action to those who satisfy the requirements of Section 18(a). Third, an implied right would *not be consistent with the legislative scheme,* since it would effectively abolish the purchaser-seller limitation that Congress placed on express damage remedies.

Finally, the rights of action that the Trustee and SIPC allege normally are asserted in common law actions for accountants' negligence and malpractice. The purchaser-seller requirement of Section 18(a) shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to State law* which, under "well established tort law principles" (*see* pp. 56-57

and n.30, 63, *supra*), provides appropriate remedies—remedies which are being pursued as against Touche Ross by the Trustee and SIPC in the State Court Action, and by Weis' customers themselves, and to which they all appropriately should be relegated (*see* pp. 6-7, 16 n.12 *supra*).

F. *Borak* Does Not Require Implication Of A Private Right Of Action Under Section 17(a).

The Court of Appeals majority erroneously relied upon *J. I. Case Co.* v. *Borak, supra,* and its "statutory tort" theory (A.199; *see also* A.206 (concurrence)), both of which have been, as Judge Mulligan's dissent notes, "significantly restricted by more recent decisions" of this Court (A.209-A.210 and n.2). As the District Court also recognized, not only is "the case at bar. . . not like *Borak*", but the "Supreme Court has refused to expand the *Borak* principle" and "indeed . . . . has restricted it" (A.180-A.182). Other decisions also have recognized that *Borak* is not authority for implying a private right of action for damages from the reporting provisions of the 1934 Act. *E.g., In re Penn Central Securities Litigation, supra,* 347 F.Supp. at 1339-1340.[41]

[41] Even accepting that *Borak* was, within the pertinent statutory context and taking into account the stage of development of remedies under the federal securities laws in 1964, properly decided, its language is so broad that it does not now provide a sufficiently discriminating analytical framework to determine whether remedies properly may be implied under the federal securities laws, which have seen 25 years of further development. While this Court's subsequent decisions preclude any unduly broad reading of *Borak* (*see, e.g.,* A.209-A.210 and n.2 (dissent); A.182 (District Court)), the reliance by the Court of Appeals majority (A.199; A.206 (concurrence)) on *Borak's* broad language, and the majority's refusal to acknowledge the restrictions imposed by subsequent decisions, demonstrate the confusion and ambiguity still generated for some lower federal courts by *Borak*. It would eliminate that confusion and ambiguity, and would provide clearer guidelines in an area where the lack of clarity seriously burdens the federal judiciary, if this Court would unequivocally state that—as is the import of its current decisions—*Borak* does not now set forth the appropriate analysis for determining the existence of implied remedies.

Section 14(a) of the 1934 Act—the statutory provision involved in *Borak*—is designed to protect a stockholder's voting rights, and (through Rule 14a-9) makes "unlawful" any false or misleading proxy statement. This Court in *Borak* found it "necessary" to imply a private right of action to protect Section 14(a) rights for various reasons which make *Borak* distinguishable from this case. In the first place, there was no express remedy provided in the 1934 Act for violations of Section 14(a), an aspect emphasized by *Piper* ("the relevant provisions are silent as to remedies"—430 U.S. at 25). Moreover, Section 14(a), far from simply imposing reporting requirements, "stemmed from the congressional belief that '*[f]air corporate sufferage is an important right* that should attach to every equity security bought on a public exchange'" (emphasis added). 377 U.S. at 431; *see also Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25.

Borak is also inapplicable here, since the Section 17(a) reports in issue were not intended to provide information to investors to aid them in their decisions or to influence them to act with respect to a particular transaction or matter. The District Court correctly recognized this, in pointing out that

> "the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any 'investors' and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act" (A.182).

Consequently, as the District Court emphasized, whereas this Court has "referred to *Borak* as an instance where there was 'a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard'", here there is "no such

'pervasive legislative scheme'" (A.182). Indeed, the "legislative scheme" of which Section 17(a) is a part includes Section 18(a) and its express remedy for the class to which Congress intended to give a remedy, and compels the conclusion (contrary to that reached in *Borak*) that Congress intended no other remedy to be available.

The Court of Appeals majority also erred by unduly emphasizing the "protection of investors" language of Section 17(a) that is similar to the language involved in *Borak* (A.196). That a particular statutory provision is intended for the "protection of investors" does not necessarily mean that a private right of action is to be implied thereunder. For example, in *Amtrak, supra,* this Court rejected the contention, based upon *Borak,* that a right of action under the Amtrak Act should be implied in favor of an association of railroad passengers simply because "railroad passengers are the intended beneficiaries of the Act". 414 U.S. at 457. *See also, e.g., Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 421 ("Congress' primary purpose . . . was, of course, the protection of investors. It does not follow, however, that an implied right of action by investors who deem themselves to be in need of [SIPA's] protection is either necessary to or indeed capable of furthering that purpose"); *In re Equity Funding Corp. of America Securities Litigation, supra,* 416 F.Supp. at 190.

Moreover, as the District Court recognized, an indispensable element of the decision in *Borak* was that an implied private remedy under Section 14(a) was a "necessary supplement to [SEC] action" because the SEC "had not the time for an 'independent examination'" of proxy material (A.181). *See also Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 25. Here, that problem is not encountered by the SEC with respect to its examination of Section 17(a) reports (see pp. 64-65 and n.40, *supra*).

G. Serious Policy Considerations Militate Against The Implication Of A Private Right Of Action Under Section 17(a).

In *Blue Chip Stamps* v. *Manor Drug Stores, supra,* this Court noted that to the extent that it was unable "to divine from the language of [Section] 10(b) [of the 1934 Act] the express 'intent of Congress'", it was proper to "consider, in addition to the factors [of statutory construction] already discussed, what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance". 421 U.S. at 737. However, in *Ernst & Ernst* v. *Hochfelder, supra,* the Court subsequently stated that it found "the language and history of §10(b) dispositive" of the question there involved and thus "there is no occasion to examine the additional considerations of 'policy,'. . . that may have influenced the lawmakers in their formulation of the statute", although it did note the serious policy difficulties that would be raised by the expanded scope of liability unsuccessfully urged by plaintiffs. 425 U.S. at 214 n.33. While the language, context and history of Sections 17(a) and 18(a) are dispositive here and require a holding that no private right of action may be implied under Section 17(a), the pertinent policy considerations, to the extent that it is appropriate to consider them, also require that holding.

1. Expansion Of The Scope Of Liability Under The 1934 Act Raises Serious Issues That More Appropriately Should Be Addressed By Congress.—This Court has observed that serious problems arise when a remedy which "would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions with respect to matters under the [federal secu-

rities] Acts" is judicially implied, and has emphasized that "we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good". *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 214-215 n.33; *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 747-748. In this connection, both *Hochfelder* and *Blue Chip Stamps* cited *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179-180, 174 N.E. 441, 444 (1931), and quoted with approval therefrom Chief Judge Cardozo's observation, "with respect to 'a liability in an indeterminate amount for an indeterminate time to an indeterminate class' ", that

> "[t]he hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences".

While in *Hochfelder* and *Blue Chip Stamps* the statutory language and history offered the guidance as to the Congressional intent that this Court found to be necessary for determining the scope of liability under Section 10(b), the language and history of Section 17(a) offer no similar guidance (except the guidance provided by Section 18(a)) as to the Congressional intent concerning the scope of liability thereunder, and there is the danger that such liability (and its substantial consequences to the accounting profession) may remain "indeterminate". Determination of its scope thus would be an inappropriate judicial task, because it necessarily would depend upon an analysis of factors which are legislative in nature and which require (but, except to the extent that they are reflected in Section 18(a),[42] have not

[42] As the legislative history and ultimate text of Section 18(a) demonstrate, Congress concluded after hearings that, even with the purchaser-seller limitation, the liability that would have been created by the originally proposed versions thereof was too broad, and

yet received) Congressional consideration in the first instance. Moreover, it would be a difficult judicial task—as is demonstrated by the fact that the Court of Appeals majority expressly declined to articulate "what the appropriate standard is for accountant liability in actions under section 17"(A.204).

Because neither Section 17(a) nor its legislative history provides any standards that would provide a sound basis for proper judicial articulation of the scope of any implied private right of action against accountants for violation of Section 17(a), the holding of the Court of Appeals majority necessarily is open-ended and has the potential for effecting an extreme expansion of the scope of civil liability under the 1934 Act. That holding is not necessarily limited to providing a federal right of action in all cases where state law would provide to customers a remedy for accountants' negligence and malpractice in auditing and certifying financial statements such as those contained in Section 17(a) reports. In this case, while the Trustee and SIPC do seek simply to "federalize" their common law claims, liability for damages resulting from the failure of the SEC, SIPC, and the self-regulatory organizations to adequately monitor and supervise the activities of a securities brokerage firm also is sought to be imposed, for the first time and without any express evidence of legislative intent to impose such liability, upon accountants whose alleged negligence and malpractice resulted in their failure to discover that their client wilfully withheld from those organizations information that *might* have enabled them more adequately to perform their required regulatory duties. The accountants would vir-

therefore limited actions thereunder by imposing a *scienter* requirement and a short statute of limitations, and by granting authority to require a plaintiff to post a bond for costs. *See Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 211-212 n.31. *See also* brief *amicus curiae* (at 9-11) of the American Institute of Certified Public Accountants.

tually be made insurers of the success of the entire regulatory scheme, including its so-called "early warning system." By accepting an engagement to render their professional opinion with respect to a brokerage firm's Section 17(a) reports, accountants would be held to have accepted thereby delegation to them of, and responsibility for, virtually all of the regulatory organizations' monitoring duties. If the regulatory system failed to achieve its objectives, as it did in the Weis situation, the regulatory authorities, whose statutory responsibility it is to protect customers, all would profess ignorance and innocence. The accountants—convenient scapegoats whom the statute does not even mention (*see also* pp. 79-80, *infra*)—would be held to blame. The risks of brokerage firm insolvency would be shifted from SIPC (upon which Congress expressly imposed those risks) to the accountants (*see also* pp. 105-106, *infra*), and they would be required to compensate the customers for the regulatory failure. Moveover, these consequences would be imposed upon the accounting profession without the slightest evidence that Congress ever considered the wisdom thereof.

Consequently, the creation of an implied private right of action under Section 17(a) here makes pertinent if not compelling the observation in *Ernst & Ernst* v. *Hochfelder* that "[a]cceptance of respondents' view would extend to new frontiers the 'hazards' of rendering expert advice under the Acts, raising serious policy questions not yet addressed by Congress". 425 U.S. at 216 n. 33.

2. IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD NEEDLESSLY BURDEN THE FEDERAL COURTS WITH LITIGATION THAT SHOULD MORE APPROPRIATELY BE RELEGATED TO THE STATE COURTS.—The recognition of a new implied right of action under Section 17(a)—a right of action not heretofore perceived by any other court or litigant in the 45

years since enactment of the 1934 Act—has the serious potential for adding to the already large volume of litigation under the 1934 Act in the federal courts, and thereby further burdening them with, an additional large volume of litigation which involves essentially claims of accountants' negligence and malpractice, and which traditionally has been, and more appropriately should be, adjudicated in the State courts. If such a right of action is implied, all customers of failed or failing brokerage firms will have a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports. The resulting likelihood of proliferating litigation is seen from the facts that (i) between 1970 and 1977, 128 brokerage firms have failed and been placed in SIPA liquidation, (ii) such failures, seven of which occurred in the last year for which data is available (1977), continue to be a fact of life in today's mercurial and often troubled securities markets, and (iii) the total number of customers of such failed brokerage firms is huge, with more than 104,000 customer claims already having been satisfied in whole or in part in SIPA liquidations as of December 31, 1977.[43] That the prospect for a greatly-expanded volume of 1934 Act litigation is real, and not simply speculative, is demonstrated by the commencement in the District Court only six days after the decision of the Court of Appeals here of a customers' class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a) *(see* p. 16 n.12, *supra)*.

Moreover, the satisfaction of customer claims in brokerage firm liquidations does not remove—indeed, appears even to increase—the potential for 1934 Act litigation, in light of the holding by the Court of Appeals majority that SIPC, to the extent that it advances funds for

[43] SIPC SEVENTH ANNUAL REPORT (1977) 5-6, 28.

payment of such claims, is subrogated to and may assert customers' Section 17(a) rights against third parties. As of December 31, 1977, SIPC had advanced almost $54,000,000 for payment of customers' claims (*i.e.*, almost $40,000,000 in excess of the $14,000,000 advanced for payment of such claims in the Weis liquidation)[44]—advances so substantial as to demonstrate a likelihood that SIPC will find itself compelled to assert such Section 17(a) claims. Of course, the potential for greatly-increased 1934 Act litigation is not limited to situations where the brokerage firm involved is in liquidation, because Section 17(a) claims could be asserted by customers with respect to the Section 17(a) reports of any of the over 5,000 brokers and dealers registered with the SEC.

Furthermore, the class of plaintiffs who may seek to invoke an implied remedy under Section 17(a) is not limited to SIPC and the presumably small number of customers whose claims for the net equity in their accounts exceed the maximum amounts of protection provided under SIPA (*see* p. 62 n.37, *supra*). Even customers whose claims do not exceed the SIPA limits, and therefore may be "fully" satisfied in accordance with the formulae set forth in SIPA, may argue that they have incurred damages the recovery of which they may seek under Section 17(a). *See Rich* v. *New York Stock Exchange,* 522 F.2d 153 (2d Cir. 1975) (holding that brokerage firm customers who ostensibly have been compensated "fully" under SIPA nevertheless may be able to prove and recover damages that arise from a brokerage firm liquidation but for which no compensation is provided under SIPA). Significantly, the Weis customers who already have sued Touche Ross as a result of the decision of the Court of Appeals majority here seek, *inter alia,* recovery

[44] SIPC SEVENTH ANNUAL REPORT (1977) 6, 28-29.

of precisely the damages referred to in *Rich* v. *New York Stock Exchange.* Since *any* customer of a defunct brokerage firm can claim to have suffered such damages, the class of plaintiffs who may seek to invoke an implied Section 17(a) remedy is huge.[45]

It is significant that the burden that would be placed upon the federal courts by the creation of a Section 17(a) implied private right of action would be an ***unnecessary*** burden. The claims asserted here, and the similar claims which might be asserted by any brokerage firm customer for misstatements in Section 17(a) reports, are essentially common law claims for accountants' negligence and malpractice, which traditionally have been a concern of State law and for which State law provides appropriate remedies (*see* pp. 56-57, 67-68, *supra*). Of course, this is evidenced here by the fact that not only do the Trustee and SIPC have pending the State Court Action, but customers of Weis also have pending New York State court actions against Touche Ross for damages allegedly resulting from Touche Ross' certification of the Weis financial reports (*see* pp. 6-7, 16 n.12, *supra*).

3. ABANDONMENT OF THE PURCHASER-SELLER REQUIREMENT OF SECTION 18(a) WOULD INCREASE THE DANGER OF VEXATIOUS LITIGATION.—As already noted (pp. 48-51, *supra*), the creation of an implied private right of action under Section 17(a), by eliminating the purchaser-seller requirement of Section 18(a), would defeat the salutary purposes of that requirement that were recognized by this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 737-749, and that led it to uphold such a requirement as necessary to avoid the

[45] For reasons stated hereinafter (pp. 103-104, *infra*), if any right of action is implied on behalf of customers for violation of Section 17(a), it should not be available to recover losses for which SIPC is required to compensate the customers. In that event, damages for which SIPC compensation is unavailable would be the only damages for which recovery could be sought under Section 17(a).

"danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749. *See also Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478-479.

4. IMPLICATION OF A PRIVATE RIGHT OF ACTION UNDER SECTION 17(a) WOULD GIVE IMPETUS TO EFFORTS TO IMPLY SIMILAR RIGHTS UNDER THE OTHER REPORTING PROVISIONS.—Since Section 17(a) is a reporting provision, a holding that a private right of action may be implied thereunder would be authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have sought to assert such implied rights in the actions already cited herein (pp. 51-54, *supra*) and, although the efforts of such plaintiffs heretofore have been unsuccessful, affirmance of the Court of Appeals majority's holding here only would give new impetus to such efforts.

II

Under Any Circumstances, Section 17(a) Does Not Create Any Implied Private Right Of Action For Damages Against Accountants, Upon Whom It Imposes No Duties, Or In The Absence Of *Scienter*

Even if it be assumed that Section 17(a) creates an implied private right of action on behalf of brokerage firm customers against their brokerage firm for damages from misstatements in its Section 17(a) reports, no such right of action may be implied (a) against accountants, because Section 17(a) does not impose any duty upon them, or (b) in the absence of *scienter,* because any implied right of action based on negligence would be *broader* than the express remedy of Section 18(a), and would be inconsistent with the holding with respect to implied remedies in *Ernst & Ernst* v. *Hochfelder, supra.*

A. Section 17(a) Imposes No Duty Upon Accountants Such As Touche Ross.

Notwithstanding whether brokerage firm customers have a Section 17(a) implied private right of action as against *their brokerage firm* for damages from misstatements in its Section 17(a) reports, no such right of action may be implied against *accountants* such as Touche Ross. The language of Section 17(a) does not refer to, and does not impose any duty upon, accountants who have allegedly audited and certified financial reports filed pursuant thereto. As the District Court held,

> "Section 17 does not impose any duty on accountants. It specifically mentions a 'national securities exchange', the members thereof, a 'registered securities association', brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate . . . the oath is only by the broker or dealer" (A.183).

Cf. Rothstein v. *Seidman & Seidman,* 410 F.Supp. 244, 248 (S.D.N.Y. 1976) (special instruction accompanying stock exchange audit rule "is directed to Exchange members . . . [and] makes no reference to nor imposes any duty upon an auditing accountant from which a private right to damages could be implied"); *In re Equity Funding Corp. of America Securities Litigation, supra,* 416 F.Supp. at 190 (Section 13(a) and rule thereunder "impose duties only on issuers and not accountants").

The Court of Appeals majority relied upon "the regulations [in Rule 17a-5] promulgated by the SEC" pursuant to Section 17(a), and the purported recognition

therein that "accountants play a significant role in the [regulatory] scheme", to support its holding that Section 17(a) "imposes a duty on accountants" (A.195). However, as the District Court recognized, while Rule 17a-5 does refer to accountants, it does not by its terms impose any duty on them. Moreover, an interpretation of Rule 17a-5 that would derive therefrom a duty on accountants that is not imposed by Section 17(a) itself would be impermissible, because it is well-established that "the language of the statute must control the interpretation of the Rule". *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 472; *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 214 ("[the] scope [of the rule] cannot exceed the power granted the Commission by Congress"). Further, any ambiguity as to whether Rule 17a-5 does in fact impose a duty upon accountants should preclude a private right of action against them from being implied thereunder. *Cf. Drasner* v. *Thomson McKinnon Securities, Inc.,* [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,080 at 91,887-91,888 (S.D.N.Y. 1977).

B. Section 17(a) Does Not Create Any Implied Private Right Of Action In The Absence Of *Scienter.*

Even if it be assumed that a private right of action may exist under Section 17(a), it is clear that *scienter* must be a necessary element thereof. *Ernst & Ernst* v. *Hochfelder, supra.* In holding that *scienter* was an essential element in a private action for damages under Section 10(b) and Rule 10b-5, *Hochfelder* observed that the "1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities", and that

> "it [is] significant that each of the express civil remedies in the 1933 Act allowing recovery for negligent conduct . . . is subject to *significant procedural restrictions* not applicable under §10(b) . . . . We think *these procedural limitations* indicate that the judicially created private damages remedy under §10(b)—which has no comparable restrictions—cannot be extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing" (emphasis added). 425 U.S. at 206, 208-210 and n.30.

The "significant procedural restrictions" referred to include authorization for a district court to require plaintiffs to post a bond for costs (including attorneys' fees) and to assess costs at the conclusion of the litigation, and a short statute of limitations. The conclusion in *Hochfelder* that it would "nullify the effectiveness of the carefully drawn procedural restrictions on these express actions [for damages for negligent conduct]" to permit actions under Section 10(b) and Rule 10b-5 absent *scienter* applies equally as well to implied private actions (if any there be) under Section 17(a), because that section and the rules thereunder, like Section 10(b) and Rule 10b-5, obviously do not contain any of the "carefully drawn procedural restrictions" which Congress deemed necessary in the express provisions allowing recovery for negligent conduct.

Hochfelder also noted that there was no substantial support in the legislative history for permitting implied actions grounded on negligence, pointing to the fact that the original proposed version of Section 18(a) (which provides the express remedy for violations of reporting provisions such as Section 17(a)) would have imposed liability for negligence, and that Section 18(a) was changed in subsequent bill drafts so as to eliminate liability for negligence after "[t]he accounting profession objected to [the original] provision on the ground that

liability would be created for honest errors in judgment". 425 U.S. at 212 n.31.[46] The reasoning of *Hochfelder* thus requires that *scienter* be a necessary element of any implied private right of action under Section 17(a).

The complaint here alleges that Touche Ross performed its services in a "negligent, reckless, careless, unskilled and grossly negligent manner" (A.15 [¶28], *see also* A.23 [¶42], A.31 [¶84]), that Touche Ross failed to conduct its audit in accordance with generally accepted auditing standards and accounting principles (A.19 [¶31]), that Touche Ross' conduct was "negligence per se" (A.22 [¶37]) and "malpractice" (A.22 [¶39], A.28 [¶72], A.29 [¶76], A.30 [¶¶80, 82], A.31 [¶84]), that Touche Ross "knew or should have known" that Weis' financial statements were false (A.23 [¶41], *see also* A.26 [¶60], A.27 [¶65], A.30 [¶¶80, 82]), that Touche Ross failed to render services "in a thorough, proper, skillful and diligent manner" (A.23 [¶45]), and that Touche Ross *"would have discovered"* the fraud perpetrated by the officers of Weis if it had "audited, verified and examined" Weis' financial statements "in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC" (emphasis added) (A.16-A.17 [¶¶29(a), 29(b)]).

Those allegations do not set forth the necessary *scienter,* but simply charge negligence. They are virtually identical to the allegations in *Hochfelder,* which charged Ernst & Ernst with " 'failure' to conduct proper audits of First Securities" and were based on the premise that

[46] *Hochfelder* also noted that "[e]ach of the provisions of the 1934 Act that expressly create civil liability, except . . . 16(b) . . . contains a state-of-mind condition requiring something more than negligence". *Id.* at 209 n.28.

"Ernst & Ernst had failed to utilize 'appropriate auditing procedures' " and that "if Ernst & Ernst had conducted a proper audit, it would have discovered th[e] 'mail rule' " by which the broker-dealer's president implemented the fraudulent scheme. 425 U.S. at 190.

III

Even If (As The Court Of Appeals Majority Held) Section 17(a) Does Create An Implied Private Right Of Action In Brokerage Firm Customers Against Accountants, The Trustee May Not Assert Such Implied Right On Behalf Of Weis Customers Whose Property He Has Been Unable To Return

The Trustee has sought to recover two distinct kinds of damages allegedly resulting from Touche Ross' violation of Section 17(a). He has sought, first, to recover on behalf of Weis itself and in Weis' own right damages that Weis allegedly suffered, and, second, to recover damages suffered by customers of Weis whose property he was unable to return because of "depletion of the property held by Weis in trust for its customers" (A.9 [¶12], A.19-A.22 [¶¶31(d)-(i), 34, 35]).[47]

[47] The complaint does not allege the manner in which the property of the Weis customers was "depleted". However, the report filed by the Trustee in the Weis liquidation proceeding after dismissal of this action by the District Court and after argument in the Court of Appeals of the appeal therefrom—a report of which this Court may take judicial notice (*see* p. 16, n.12, *supra*)—gives the following explanation with respect to customer securities found to be "missing" at the commencement of the liquidation: "Most of the 'missing' securities were included in the collateral liquidated by banks to which Weis had pledged them to cover loans. The shortages were also caused by failures to receive securities due from other brokers and by temporary lags occurring in the normal course of business in the

The Court of Appeals majority and Judge Mulligan agreed, relying upon *Piper* v. *Chris-Craft Industries, Inc., supra,* and *Lank* v. *New York Stock Exchange, supra,* that the Trustee is not entitled to assert any claim on behalf of Weis itself under Section 17(a), because Weis was a member of the class regulated by, and not a beneficiary of, Section 17(a) (A.202-A.203, A.222-A.224 (dissent)). The Trustee has not sought review of that holding, the correctness of which is beyond dispute.

However, with respect to the Trustee's claims on behalf of the Weis customers, the Court of Appeals majority held, in purported reliance upon the common law doctrine of bailment and Rule 17(a), F.R. Civ. P., and over Judge Mulligan's dissent, that the Trustee "as bailee of the property of Weis' customers" is "an appropriate real party in interest to maintain this action on their behalf", to "the extent that customers have claims that have not been satisfied by either Weis in liquidation . . . or by SIPC" (A.203-A.204, A.223-A.224 (dissent)). As demonstrated hereinafter, that holding of the Court of Appeals majority is erroneous because (a) neither the common law doctrine nor Rule 17(a) confers upon the Trustee any right to assert customer rights of action (if any there be) under Section 17(a), and (b) *Caplin* v. *Marine Midland Grace Trust Co.,* 406 U.S. 416 (1972), precludes the Trustee from otherwise asserting such claims.

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issuance of instructions to segregate fully-paid securities or in obtaining possession or control of such securities pursuant to Rule 15c3-3. No evidence of theft or misappropriation of customer securities has been discovered." REDINGTON, REPORT OF THE TRUSTEE FOR THE LIQUIDATION OF THE BUSINESS OF WEIS SECURITIES, INC. 42 (December 8, 1977).

A. The Trustee Is Not Entitled As Bailee Of Customer Property To Assert Any Customer Rights of Action Under Section 17(a).

Under Section 6(b)(1) of SIPA, 15 U.S.C. §78fff(b)(1) (1970), the Trustee has the same title to property and rights as a bankruptcy or Chapter X trustee, and thus succeeded only to the rights of Weis itself, and not to any rights of the Weis customers that Weis itself could not assert. *See, e.g., Caplin* v. *Marine Midland Grace Trust Co., supra; In re Petroleum Corp. of America,* 417 F.2d 929 (8th Cir. 1969) (*see also* pp. 96-98, *infra*). Consequently, the Trustee may assert rights as purported "bailee" of customer property only to the extent that Weis itself was a "bailee" and could have asserted such rights.

The Trustee argued, and the Court of Appeals majority held, that the Trustee (having succeeded to the rights of Weis) "may sue on behalf of the customers/bailors any wrongdoer whom they could sue themselves" (A.203). That argument and that holding were purportedly based upon the common law doctrine of bailment, under which "[a] bailee may recover from a third person for the latter's wrongful injury to bailed property or disturbance of his possession thereof", 8 C.J.S. *Bailments* §39 at 474, and upon the provision of Rule 17(a), F.R. Civ. P., that permits a bailee to "sue in his own name without joining with him the party for whose benefit the action is brought" (*see* A.203-A.204). Analysis demonstrates, however, that, under the common law doctrine and Rule 17(a), the only bailment rights that the Trustee (as Weis' successor) may assert are *Weis' own rights* (and, of course, the Trustee has no Section 17(a) right of action for any alleged invasion of those rights, since Weis was regulated by, and not a beneficiary of, Section 17(a))—and *not any rights of the customers-bailors* (including the customers' purported rights of action under Section 17(a) against Touche

Ross). Moreover, the analysis demonstrates that it is totally inappropriate to refer to the common law doctrine of bailment to determine whether the Trustee may assert any federal Section 17(a) rights of the Weis customers.

1. THE COMMON LAW DOCTRINE REGARDING THE RIGHTS OF A BAILEE DOES NOT GIVE THE TRUSTEE ANY RIGHT TO ASSERT CUSTOMER RIGHTS OF ACTION UNDER SECTION 17(a).—The common law doctrine that permits a bailee (*e.g.*, Weis, or the Trustee as its successor) to sue a third party for loss of, or injury to, the bailed property is based upon *the bailee's own possessory rights,* and not upon any theory that the bailee is asserting the rights of the bailor *(e.g.,* customers of Weis). *See* W. PROSSER, LAW OF TORTS §15 at 94-95 (4th ed. 1971). As stated by Mr. Justice Holmes in his work on the common law, in early times the right to make use of possessory remedies "depended on possession, and not on ownership" and "was confined to the man in possession, and was not open to the owner unless he was that man". O. HOLMES, THE COMMON LAW 166 (1881). Thus, as Holmes explained,

> "[t]he meaning of the rule that all bailees have the possessory remedies is, that *in the theory of the common law every bailee has a true possession,* and that *a bailee recovers on the strength of his possession,* just as a finder does, and, as even a wrongful possessor may have full damages or a return of the specific thing from a stranger to the title" (emphasis added). *Id.* at 174.

Later, during the time of the Year Books, some confusion did develop as to whether a bailee's right to sue was based simply upon his possession or upon his liability over to the bailor, *id.* at 170, an issue that became of practical importance only after the decision in *Coggs* v. *Bernard,* 2 Ld. Raym. 909, 92 Eng. Rep. 107 (1704), which eliminated the bailee's absolute liability to the bailor, *see* 7

W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 451 (2d ed. 1937). However, the thorough analysis of English and nineteenth-century American[48] precedents set forth in the decision of the English Court of Appeal in the seminal case, *The Winkfield,* [1902] P. 42 (C.A.), "removed the confusion as to the real basis of the bailee's rights . . . [and] gave effect to the view, which Holmes had advocated, that *the bailee can sue because he is a possessor*" (emphasis added). 7 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW, *supra,* at 454-455 (also noting that "the [C]ourt of Appeal, in thus following Holmes, adopted the true historical view").[49] As the Court of Appeal stated in *The Winkfield,* "the wrongdoer . . . must treat the possessor as the owner of the goods *for all purposes* . . . . [T]he root principle . . . is that, as against a wrongdoer, possession is title. The chattel that has been converted or damaged is deemed to be *the chattel of the possessor and*

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[48] *Parish* v. *Wheeler,* 22 N.Y. 494 (1860); *Ullman* v. *Barnard,* 73 Mass. 554 (1856); *White* v. *Webb,* 15 Conn. 302 (1842). *See also Chamberlain* v. *West,* 37 Minn. 54, 33 N.W. 114 (1887); *Brewster* v. *Warner,* 136 Mass. 57, 49 Am. Rep. 5 (1883) (Holmes, J.).

[49] The holding of *The Winkfield* was that the bailee may recover the full value of the chattel simply on the strength of his possession and without regard to whether under the circumstances he would be liable for loss or destruction to the true owner, to whom he nonetheless must account for any recovery (*see also* pp. 88-89 n.50, *infra*), and that a full recovery by the bailee bars any action by the bailor. *The Winkfield* is the leading modern authority articulating the common law doctrine and the conceptual basis thereof, and is cited as such an authority in modern American cases. *See, e.g., Berger* v. *34th St. Garage, Inc.,* 274 App. Div. 414, 416, 84 N.Y.S.2d 348, 350 (1st Dep't 1948) ("The leading case on this subject which reviews the history of the doctrine is *The Winkfield*"), *mot. for leave to app. denied,* 275 App. Div. 660, 86 N.Y.S.2d 667 (1st Dep't 1949); *Luckenbach Steamship Co.* v. *United States,* 315 F.2d 598, 605 (2d Cir. 1963); *Paragon Oil Co.* v. *Republic Tankers, S.A.,* 310 F.2d 169, 175 (2d Cir. 1962), *cert. denied sub nom. Yacimientos Petroliferos Fiscales* v. *Paragon Oil Co.,* 372 U.S. 967 (1963); *American Surety Co.* v. *Baker,* 172 F.2d 689, 691 (4th Cir. 1949). *See generally* Comment, *A Re-examination of the Winkfield Case,* 9 FORDHAM L. REV. 247 (1940) ("The *Winkfield* case established the modern rule declaring the respective rights and liabilities existing within the legal triangle involving a bailor, the bailee and a third party who damages or converts the bailor's property while in the bailee's possession").

of no other" (emphasis added). [1902] P. at 54-55, 60. *See also* 1 F. HARPER & F. JAMES, LAW OF TORTS 98 (1956) ("[T]he possessor . . . is treated as though he were owner, i.e., as though he had the entire property interest in the goods. In other words, as against a 'stranger' . . . the person in possession *is* the owner").

Moreover, despite any confusion that once may have existed concerning the basis for the bailee's right to sue, it always has been clear under the common law doctrine that the rights that the bailee may assert as against a third person are *his own rights* arising from his possession, and that he may neither assert the bailor's personal rights nor purport to act as the bailor's legal representative. *See, e.g., Nash* v. *Lang,* 268 Mass. 407, 414, 167 N.E. 762, 765 (1929) ("*The bailee does not stand in the place of the bailor nor represent him.* He is not servant or agent of the bailor . . . . *The two have separate, distinct and independent rights and obligations* with respect to each other, and with respect to third persons"); *Green* v. *Clarke,* 12 N.Y. 343, 353 (1855) ("It is a general rule that a bailee having a special property and the general owner may either of them sustain an action for the conversion of or an injury to property in which they are interested. The right to sue is indispensable *to enable each to protect his particular interest*") (emphasis added).[50]

[50] The bailee's duty to account to the bailor for any recovery from a third party is not an element of the bailee's right to recover in the first instance, and that duty provides no basis for any attempt by the bailee to sue the third party on behalf of the bailor as the bailor's representative. The bailee's duty to account arises if he is able to recover *in his own right* the value of the property, and it then arises only *as a consequence* of that recovery, which the bailee holds in place of the property itself. In determining whether the bailee may recover from the third party, the law "is quite unconcerned with what the rights are between the bailor and bailee", and thus the bailee's "obligation to account to the bailor is really not ad rem in the discussion. It only comes in after he has carried his legal position to its logical consequence against a wrongdoer, and serves to soothe a mind disconcerted by the notion that a person who is not himself the complete owner should be entitled to receive back the full value of the chattel converted or destroyed". *The Winkfield, supra,* [1902] P. at 54, 60. *See also Berger* v. *34th St. Garage, Inc., supra,* 274 App. Div. at 420, 84 N.Y.S.2d at 353 ("[T]he words used in this complaint . . . that the suit was being brought on behalf of the owner of the property, is merely a statement of what the law requires of the plaintiff in the event of recovery . . . [T]he matter need not be pleaded because it is immaterial").

In light of the foregoing, even if common law principles be assumed to apply to implied rights of action under the 1934 Act (*but see* pp. 92-94, *infra*), the common law doctrine of bailment provides no basis for the Trustee to assert any private rights of action of the Weis customers under Section 17(a), for several reasons.

In the first place, any action brought by the Trustee (as successor to Weis) to recover as "bailee" of customer property necessarily is an action to vindicate Weis' *own possessory rights,* and not the rights of the customers-bailors. This means that denomination of the Trustee as a "bailee" does not give him any right of action under Section 17(a). As even the Court of Appeals majority recognized (*see* p. 84, *supra*), Weis itself, and therefore the Trustee, have no right of action under Section 17(a) to vindicate Weis' own rights, because Weis is a member of the class regulated by, rather than a member of the class protected, by Section 17(a). This was precisely the point made by Judge Mulligan (and missed by the majority in failing to understand that a "bailee" asserts *his own possessory interest* and not any of his bailor) when he emphasized that, "I fail to see how denominating [the Trustee] a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act" (A.224).

The Trustee cannot avoid that simple and dispositive point by arguing that the bailed property actually belongs to the customers-bailors and that they satisfy the necessary condition of membership in the class protected by Section

17(a). The common law doctrine does not permit a bailee who cannot demonstrate satisfaction of an essential condition for recovery to circumvent such a condition by asserting (as the Trustee does here) that the bailor could satisfy it, and that any recovery by the bailee will be held in trust for the bailor. For example, while a bailee must show his own freedom from contributory negligence to recover on a claim for the defendant's negligent injury to the property, the bailee's contributory negligence will not be imputed to the bailor so as to bar recovery by the bailor against the defendant. *See generally* W. PROSSER, LAW OF TORTS, *supra,* §74 at 491 (noting that old cases that imputed such negligence to the bailor have been overruled because of "modern acceptance of the interests of the bailor and the bailee as quite separate and distinct"). In such circumstances, a negligent bailee cannot circumvent the requirement that he establish his own freedom from contributory negligence by arguing that the bailor could satisfy that requirement, and that any recovery will be held in trust for the bailor.[51] *See also* pp. 88-89 n.50, *supra.*

Significantly, the Trustee's "bailee" claim perverts the basic rationale of the common law doctrine. As shown hereinabove, under the common law doctrine the true ownership of the property is not given any real signifi-

[51] *Cf. Commercial Banking Corp.* v. *Philadelphia Transp. Co.,* 162 Pa.Super. 158, 56 A.2d 344 (1948) (bailee's insurer could not avoid defense of bailee's contributory negligence by bringing suit in bailor's name); RESTATEMENT OF RESTITUTION §94 and Comment b, Illustration 4 (1937)(negligent bailee who has paid owner for damage is not entitled to restitution from third person whose negligence also caused the damage, because the bailee could not "have recovered from the third person for an injury so caused to himself or to his own property"). *See also Harvard Trust Co.* v. *Racheotes,* 337 Mass. 73, 147 N.E.2d 817, 819 (1958) (contributorily negligent chattel mortgagor, whose rights were similar to those of a bailee, could not recover his own damages by virtue of chattel mortgagee's ability to sue despite that negligence, because otherwise it "would be permitting [the mortgagor] to accomplish indirectly what he could not accomplish directly . . . [and] to reap benefits to which, had there been no mortgage, he would not be entitled").

cance in an action between the possessor and a wrongdoer, and the possessor is treated by virtue of his possession as though he were owner. The bailee thus recovers on the strength simply of his possession, and the wrongdoer is not permitted to plead as a defense the right of the owner unless he claims under it. Here, however, since only the Weis customers (and not Weis itself) have any rights of action implied from Section 17(a), the Trustee can maintain this action only by emphasizing, rather than (as under the common law doctrine) disregarding, the true ownership.

Consequently, if common law principles applied, they would treat Weis as owner of the bailed property, and would give to the Trustee none of the bailors' personal rights derived from their protected status as customers. Under those principles the Trustee would have no greater rights with respect to the bailed property than he would have if the property actually had belonged to Weis itself, and would not be able to assert customer rights of action under Section 17(a).

Even aside from the foregoing considerations, it is erroneous to treat the question of whether the Trustee may assert any Section 17(a) rights of action accruing to the Weis customers as governed by the rights of a bailee to sue for loss or injury to bailed property. As the cited authorities show, the bailee's rights arise because of actual interference by a third party with its possession of tangible property (*e.g.*, interference by conversion of or physical damage to the property), whereas any Section 17(a) rights of action of the Weis customers are not rights of action for such interference with possessory rights, but are instead personal rights to recover for injury arising out of a relationship to which the statute provides special protection. The Section 17(a) rights accrue (if at all) only to customers because of their membership in the limited class

for the special benefit of which Section 17(a) was enacted—not because of their possession, or delivery of possession, of tangible property. They may be asserted against a defendant such as Touche Ross only because it has allegedly breached a duty that it owes to that limited class alone—and not because it has interfered with any possessory interests.

Any Section 17(a) right of action therefore is completely unlike the rights of action usually asserted by bailees (such as, for example, for conversion or physical damage), which are available generally, rather than to a special class, and which may be asserted by any possessor of property in his own right simply because he has possession and because the defendant has interfered with that possession and thereby breached a duty that he owes to the actual possessor. Consequently, any Section 17(a) right of action is completely outside of the scope of the common law doctrine permitting a bailee to sue for trespass upon or injury to bailed property.

Finally, while the common law doctrine of bailment thus provides no basis for the Trustee to assert any Section 17(a) rights of action of the customers, the common law doctrine would not under any circumstances be determinative here because " 'the extent and nature of the legal consequences of [a violation of Section 17(a)] . . . are nevertheless federal questions' ", as are the incidents of any implied right of action therefor. *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433, *quoting Sola Electric Co.* v. *Jefferson Electric Co.,* 317 U.S. 173, 176 (1942); *cf. Stella* v. *Kaiser,* 221 F.2d 115 (2d Cir.) (effect of release on claim under the 1934 Act is a question of federal law), *cert. denied,* 350 U.S. 835 (1955); *Globus, Inc.* v. *Law Research Service, Inc.,* 318 F.Supp. 955, 958 n.2 (S.D.N.Y. 1970) (indemnity and contribution), *aff'd,* 442 F.2d 1346 (2d Cir.), *cert. denied sub nom. Law Research Service, Inc.* v. *Blair & Co.,* 404 U.S. 941 (1971).

Consequently, whether a bailee of customers' property who himself is not a customer has a Section 17(a) right of action is a question to be decided under the substantive principles governing construction of the federal securities laws. As made clear in *Piper* v. *Chris-Craft Industries, Inc., supra,* implied rights of action under the 1934 Act do not exist in the abstract; rather, the question of who may assert such a right of action is fundamental to the determination of whether any implied right of action exists at all. *See also Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64 (the issue correctly characterized was whether plaintiff stated a "claim for relief" under Section 6, not whether he had "standing" to do so). A mere bailee of customers' property is not an intended beneficiary of Section 17(a), particularly where the bailee is a brokerage firm (*e.g.,* Weis) belonging to the very class whose conduct is regulated thereby. Nor is it necessary in order to effectuate the congresssional purpose to give a right of action for violation of Section 17(a) to such a bailee (to whom there are available adequate state law remedies for any interference with his possessory interests), especially where his own wrongdoing has led to his alleged injury. *See also Miller* v. *New York Produce Exchange,* 550 F.2d 762, 768-769 (2d Cir. 1977) (bankruptcy trustee of defunct brokerage firm cannot recover for violations of Commodity Exchange Act from defendant whose "only sin is its failure to prevent transgressions by the plaintiff"). The federal principles governing the implication of implied rights of action under the 1934 Act therefore require a holding that such a bailee may not

assert such rights, irrespective of the common law doctrine.[52]

2. RULE 17(a), F.R.CIV.P., DOES NOT GIVE THE TRUSTEE ANY RIGHT TO ASSERT CUSTOMER RIGHTS OF ACTION UNDER SECTION 17(a).—In a ruling apparently of first impression, the Court of Appeals majority relied upon Rule 17(a), F.R. Civ. P. (as amended in 1966) in holding that the Trustee may sue as the "bailee" of customers' property (A. 203-204). That reliance and that holding are erroneous, because Rule 17(a) provides only procedural, and not substantive, rights.

Rule 17(a), which requires an action to be prosecuted in the name of the "real party in interest", provides that "[a] bailee . . . may sue in his own name without joining with him the party for whose benefit the action is brought". The Advisory Committee Notes to Rule 17(a) make clear that it only restates the common law doctrine permitting a bailee to sue for interference with his possessory interest, stating that the purpose of the 1966 amendment was

> "[to add] to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed. (When the *possessor* of property other than the owner sues *for an invasion of the possessory interest* he is the real party in interest.)" (emphasis added). 39 F.R.D. at 84-85.

Professor Moore emphasizes that the "real party in interest" is *"the party who, by the substantive law, has the right sought to be enforced"*, 3A MOORE'S FEDERAL PRACTICE ¶17.02 at 17-13, ¶17.07 at 17-65 (2d ed. 1978). He also points out that the 1966 amendment to Rule 17(a) was simply procedural and has no substantive effect:

> "[t]his amendment was declaratory of existing admiralty and civil practice . . . . However, the declaration of *this procedural rule should not affect various substantive rules* which control the three-way relationship between the bailor, the bailee, and the third party" (emphasis added). *Id.*, ¶¶17.12 at 17-153-17-154.

See also 6 C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE §1548 at 676-677 ("In 1966, the word 'bailee' was added to Rule 17(a). This represents a codification of the admiralty practice . . . . The underlying rationale for the inclusion of the reference to 'bailee' is that when someone in possession of property sues for an injury to the property, he is the real party in interest even though he may not be the owner of the goods.").

Consequently, Rule 17(a) merely provides procedural authority for the Trustee to assert whatever substantive rights he may have to sue as "bailee". Since, as demonstrated hereinabove, the Trustee has no such substantive right to assert any Section 17(a) rights of action of the customers, Rule 17(a) does not provide any basis for the Trustee to maintain this action.

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[52] To the extent that this Court, in deciding as a matter of federal law whether to permit a bailee who is not an intended beneficiary of Section 17(a) to assert any implied private right of action thereunder, might consider the common law doctrine as a source of guidance, it should be noted that the common law doctrine has been criticized to the extent that it permits a bailee to recover beyond his own interest without the consent of the owner to bring the action. This is because, among other reasons, the bailee, even though he is required to account to the owner for any recovery, may not be able properly to represent the owner's interests. *See, e.g., Panama Canal Co.* v. *Stockard & Co.*, 391 Pa. 374, 137 A.2d 793 (1958) (requiring bailor's consent); W. PROSSER, LAW OF TORTS § 15 at 95 (4th ed. 1971); Warren, *Qualifying as Plaintiff in an Action for a Conversion*, 49 HARV. L. REV. 1084, 1097-1099 (1936); Comment, *A Re-examination of the Winkfield Case*, 9 FORDHAM L. REV. 247 (1940). *See also* p. 98, *infra* (Trustee's inadequacy as customers' class representative).

B. *Caplin* v. *Marine Midland Grace Trust Co.* Precludes The Trustee From Otherwise Asserting Any Customer Rights Of Action Under Section 17(a).

Even aside from the fact that the Trustee is not entitled as a purported "bailee" to assert any Section 17(a) rights of action of the Weis customers, he is not otherwise entitled to assert any such rights. *Caplin* v. *Marine Midland Grace Trust Co., supra,* establishes the principle that a bankruptcy or Chapter X trustee, and therefore the Trustee here, is not a proper party to assert claims of the Weis customers (who are, of course, creditors of Weis to the extent that their claims against Weis are unsatisfied). *Caplin* held that the Chapter X trustee of a corporation has no standing to assert claims on behalf of any particular class of creditors (there, holders of its debentures) against third parties, because

> "[i] nowhere in the statutory scheme is there any suggestion that the trustee . . . is to assume the responsibility of suing third parties on behalf of debenture holders . . . . [ii] [the corporation] could [not] make any claim . . . [and thus] any suit by debenture holders would not affect the interests of other parties to the reorganization . . . [iii] a suit by him on behalf of debenture holders may be inconsistent with any independent actions that they might bring themselves." 406 U.S. at 428-432.

Caplin compels the conclusion here that the Trustee may not sue on behalf of any particular class of creditors of Weis, including the class specified by the Court of Appeals majority, *viz.,* those Weis customers whose claims against Weis for their property have not been satisfied.

In the first place, as in *Caplin,* there is no statutory authorization for any such suit. While the Court of Appeals majority did not purport to find any statutory

authority for the Trustee to assert claims belonging to customers, in sustaining the Trustee's bailee argument it did assert that the Trustee "is responsible for marshalling and returning [customers'] property" (A. 203). However, none of the provisions of SIPA requiring the Trustee to marshal and return customers' property authorizes the Trustee to assert claims that belong uniquely to the customers. *See* 15 U.S.C. §§78fff(a)(1), 78fff(c)(2)(B), 78fff(c)(2)(C)(1970); *cf. Caplin* v. *Marine Midland Grace Trust Co.,* 439 F.2d 118, 123 (2d Cir. 1971) ("[A] trustee appointed . . . 'with the title of the bankrupt' [succeeds] to eight types of property . . . . None of these, by the remotest stretch of language or even of imagination, could include the claims of the debenture holders against an indenture trustee for permitting the debtor to violate convenants made by the debtor . . . for the bondholders' protection"), *aff'd,* 406 U.S. 416 (1972). While the "single and separate fund" of customer property defined in Section 6(c)(2)(B) of SIPA, 15 U.S.C. §§78fff(c)(2)(B)(1970), does include "the proceeds of all customers' property transferred by the debtor", any customer claims against Touche Ross for violation of Section 17(a) are not claims that may be asserted by the Trustee to recover any fraudulent or voidable transfer of such property and cannot "by the remotest stretch of language or even of imagination" properly be characterized as "proceeds" of such property.

Second, any recovery by the Trustee would be on behalf of the customers only and would be of no benefit to other general creditors, since, as this Court observed in *Caplin,* the customers can prove in the liquidation the full amount of their claims and may recover from Touche Ross only to the extent that their claims are not satisfied in the liquidation. 406 U.S. at 430-431. Also, although Touche Ross would not be required to pay to the custom-

ers any amount in excess of that deficiency, any such excess payment would, under the Second Circuit's holding in *Caplin*, subrogate Touche Ross to the customers' claims against the Weis general estate. *See id.* at 430; *cf. Morgan* v. *Graham*, 228 F.2d 625, 628 (10th Cir. 1956).

Third, there would be a proliferation of litigation since Weis' customers can sue—indeed, already have sued (see p. 16 n.12, *supra*)—Touche Ross; the Trustee may be unable to bind the customers to any settlement; and the Trustee would be inappropriate as the customers' class representative, since he has no common interest with them and may have conflicting interests, in view of his obligations to general creditors and others. One source of such conflicting interests would be the fact that, to the extent that Touche Ross might be held liable to the customers, it would have a claim against Weis as a joint tortfeasor for indemnification or contribution based upon Weis' filing of Section 17(a) reports that were false and contained the misstatements that Touche Ross failed to discover. Of overriding significance, however, is the fact, recognized by Judge Mulligan's dissent (A.224), that such proliferation of litigation is *unnecessary*. *See also Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 67 (holding it impermissible for a receiver of a brokerage firm to sue where the brokerage firm could not, even though any recovery would be for the benefit of public investors, because "those investors already have a cause of action in their own right . . . and the receiver's suit would add nothing to their rights").

IV

Even If (As The Court Of Appeals Majority Held) Section 17(a) Does Create An Implied Private Right Of Action In Brokerage Firm Customers Against Accountants, SIPC May Not Assert Such Implied Right As Subrogee Of Weis Customers For The Payment Of Whose Claims It Has Advanced Funds To The Trustee

SIPC has sought to recover damages (*viz.*, the $14,000,000 by which the "SIPC fund" allegedly was "depleted") on two different theories. First, SIPC has sought to recover such damages in its own right, on the theory that Section 17(a) imposes upon accountants duties which Touche Ross owed directly to SIPC and for the breach of which SIPC as an intended beneficiary has an implied private right of action. Second, SIPC has sought to recover such damages as subrogee of customers for the payment of whose claims SIPC advanced funds to the Trustee, on the theory that the customers as intended beneficiaries of Section 17(a) have an implied private right of action and that SIPC, upon advancing such funds, became subrogated to their right of action.

The Court of Appeals majority and Judge Mulligan agreed that SIPC in its own right cannot assert any implied right of action for violation of Section 17(a), because "it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or 1970" (A.201 n.13, A.222-A.223 (dissent)). That clearly correct holding is not presently before this Court.[53]

However, the Court of Appeals majority held, over Judge Mulligan's dissent, that SIPC as "subrogee" could

[53] SIPC's conditional cross-petition in No. 78-526, which is apparently still *sub judice*, seeks review of that holding.

assert the Section 17(a) right of action of the Weis customers by reason of "SIPC's general common-law right of equitable subrogation" (A.201-A.202, A.223 (dissent)). As demonstrated hereinafter, that holding is erroneous because (a) Section 6(f)(1) of SIPA expressly sets forth SIPC's exclusive subrogation remedy, by which SIPC is subrogated only to the customer "claims" *against the Weis estate,* and (b) the limitation of SIPC's subrogation rights to those enumerated in SIPA also is required by the statutory scheme and general equitable principles.

A. Section 6(f)(1) Of SIPA, By Which SIPC Is Subrogated Only To Customer Claims Against The Weis Estate, Is Exclusive And Precludes SIPC From Subrogation To Any Customer Rights Of Action Under Section 17(a) Against Touche Ross.

SIPC was created by and its powers are specified in SIPA, which establishes a comprehensive statutory scheme for brokerage firm liquidations. The only subrogation rights provided to SIPC by SIPA are set forth in Section 6(f)(1), as follows:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be *subrogated to the claims of such customers with the rights and priorities provided in this section"* (emphasis added). 15 U.S.C. §§78fff(f)(1)(1970).

As the Court of Appeals majority and Judge Mulligan in dissent correctly held (A.202, A.223), Section 6(f)(1) subrogates SIPC, when it advances funds to pay "claims" of the Weis customers, only to the "claims" of such customers *against the estate of the brokerage firm (i.e., the Weis estate).*[54]

[54] The "claims" to which SIPC is subrogated under section 6(f)(1) include only claims of customers against the estate of the debtor (*i.e.,* Weis). The term "claims" is used uniformly throughout Section 6 of SIPA to include claims against the debtor's estate only, and it is a settled principle of statutory construction that when the same word or phrase is used in the same section of a statute more than once, and the meaning is clear in one place, it will be construed to have the same meaning in the other places. *E.g., Meyer* v. *United States,* 175 F.2d 45, 47 (2d Cir. 1949); *United States* v. *Vargas,* 380 F.Supp. 1162, 1166 (E.D.N.Y. 1974); *cf. United States* v. *Cooper Corp.,* 312 U.S. 600, 606 (1941) (different sections of same act). Section 6(f)(1) itself, which provides that SIPC is "subrogated to the *claims* of such customers", makes clear that "the claims" to which SIPC is subrogated are "the claims of customers" which are referred to in the introductory clause and for payment of which "moneys are advanced by SIPC to the trustee". To include within the term "claim" causes of action against persons other than the debtor would render totally inapposite the qualification in Section 6(f)(1) that "SIPC shall be subrogated . . . *with the rights and priorities provided in this section*" (emphasis added), and also would conflict with the express definition in the Bankruptcy Act of the term "claims"—a definition which is pertinent, if not controlling, under SIPA. *See* Section 6(c)(1) of SIPA, 15 U.S.C. § 78fff(c)(1)(1970). Section 106(1) of the Bankruptcy Act, 11 U.S.C. §506(1), defines "claims" as follows: "claims shall include all claims of whatever character *against a debtor or its property,* except stock" (emphasis added). *See* 6 W. COLLIER, BANKRUPTCY ¶ 2.05 at 307 (14th ed. 1978) ("To come within the terms of § 106(1) . . . it is *essential that the claim in question be predicated against either the debtor or the debtor's property*" (emphasis added)).

In light of the comprehensive statutory scheme of SIPA, Congress clearly intended that the sole express statutory provision in Section 6(f)(1) for subrogation of SIPC to customer "claims" against the brokerage firm estate be SIPC's exclusive subrogation remedy, and that SIPC's subrogation rights not extend to customer rights of action against third parties. *See, e.g., Amtrak, supra,* 414 U.S. at 458 (requiring application of *expressio unius* doctrine because "when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies"); *Securities Investor Protection Corp.* v. *Barbour, supra; Rogers* v. *National Surety Co.,* 116 Neb. 170, 216 N.W. 182 (1927) (under statute establishing a "depositors' guaranty fund", express provision subrogating such fund to the rights of creditors paid by the fund to participate in the defunct bank's assets held, under *expresssio unius* doctrine, to be the fund's exclusive subrogation remedy); pp. 41-43, *supra. See also* H.R. REP. NO. 91-1613,

reprinted in [1970] U.S. CODE CONG. & AD. NEWS 5254, 5262 ("It is . . . contemplated that, when the liquidation proceedings are completed, SIPC will receive back some moneys *from the trustee*" (emphasis added)).

Thus, SIPC has no subrogation rights against any third party (*e.g.*, Touche Ross) whom the Weis customers could sue, under Section 17(a) or otherwise. The contrary holding by the Court of Appeals majority conflicts with this Court's decisions requiring application of the *expressio unius* doctrine and would circumvent the intent of Congress as expressed in SIPA. As Judge Mulligan's dissent emphasizes, SIPC is "a congressionally created corporation with limited powers to litigate" (A.223), and has only the subrogation rights expressly provided by SIPA.

B. The Limitation Of SIPC's Subrogation Rights To Those Enumerated In SIPA Also Is Required By The Statutory Scheme And General Equitable Principles.

The Court of Appeals majority rationalized its holding that SIPC is subrogated to customer rights of action against Touche Ross for violation of Section 17(a) on three purported grounds, *viz.*, (i) "SIPC's general common-law right of equitable subrogation", (ii) "the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC", and (iii) "the intent of Congress . . . that SIPC be able to recoup its losses from solvent wrongdoers" (A.202). As shown hereinafter, each of those grounds is fallacious, and there thus is no acceptable basis for the majority's holding.

1. As is the case in determining whether the Trustee as "bailee" can assert any Section 17(a) right of action (*see* pp. 92-94, *supra*), the question whether SIPC as "subrogee" may assert any such right is a question to be decided as a matter of substantive federal securities law.

Under the analysis required by *Piper* v. *Chris-Craft Industries, Inc., supra*, whether it is necessary to permit a particular party to assert such a right is a question that must be considered in the first instance, and is not a secondary question to be decided under general common-law principles after the right may be found to exist in the abstract. Even if it be assumed that the *expressio unuis* doctrine is not controlling here, subrogation rights other than those expressly set forth in SIPA should be recognized, if at all, only if it is necessary for the effectuation of the primary legislative purpose.

Moreover, even if the question of subrogation here were governed by the "general rule", relied upon by the Court of Appeals majority, that "upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss" (A.202, *quoting* 31 N.Y. JURISPRUDENCE *Insurance* §1620 at 510), a court in applying that rule would be required first to determine whether it is necessary, in order to effectuate Congressional goals, to imply a Section 17(a) private right of action on behalf of customers to recover losses for which SIPC is required to compensate them pursuant to SIPA, where the only beneficiary of implying such a right in reality will be SIPC (if its right to subrogation is upheld), rather than the customers. That question is of course distinguishable from the question whether customers should have an implied right of action for losses for which SIPC is not required to compensate them, where the real beneficiary of any recovery would be the customers themselves rather than SIPC. If it were to be decided, as it should be, that customers have no implied private right of action for a third party's violation of Section 17(a) for losses for which SIPC has com-

pensated them, then even under the general common-law rule there would be no claim that SIPC could assert as subrogee against the third party.

Whatever the approach, the pertinent considerations require a holding that SIPC may not sue here as "subrogee". Those considerations are in large part the same as the considerations that require the holding that SIPC in its own right may not assert any Section 17(a) right of action, because permitting SIPC to sue as subrogee simply would make the holding with respect to SIPC's entitlement to sue in its own right illusory. Congress enacted SIPA to provide additional protection to customers of securities brokerage firms in accordance with a comprehensive statutory scheme that expressly sets forth in detail the precise protection that Congress thought to be necessary and appropriate, an important aspect of which is SIPC's responsibility to advance funds for the payment of customers' claims (*see* p. 62 n.37, *supra*). SIPA also sets forth the precise and limited subrogation rights that SIPC shall have upon advancing those funds (*see* pp. 100-102, *supra*). Once customers have received the SIPC funds to which they are entitled, they have received the protection that Congress thought necessary, and which Congress created SIPC in order to provide. At that point, it is not necessary in order to effectuate the Congressional purpose of providing protection to customers to imply any private right of action for violation of Section 17(a), either on their behalf or on behalf of SIPC as subrogee. The only purpose of implying such a right of action and recognizing SIPC's subrogation thereto would be to benefit SIPC, not the customers. *Cf. Bangor Punta Operations, Inc.* v. *Bangor & Aroostook Railroad Co., supra,* 417 U.S. at 713 (courts should "look . . . to the true substance of the claims and the actual beneficiaries . . . . piercing all fictions and disguises").

Furthermore, the result of permitting SIPC to sue as "subrogee" would be to transfer from SIPC (and the brokerage firms generally that are required to contribute to the "SIPC fund") to a third party such as Touche Ross the burden of providing the financial protection to customers that Congress specifically created SIPC in order to provide. However, SIPC is not a "beneficiary" of the 1934 Act and the primary legislative purpose obviously was not to benefit SIPC. In creating SIPC, as in enacting the 1934 Act itself, Congress spoke of directly benefiting public investors only. *See, e.g.,* 116 CONG. REC. 39350 (1970) (remarks of Rep. Moss). The statutory scheme enacted by Congress creates "a unique pattern of regulation combining both industry and government responsibility". S. REP. NO. 94-75, 94th Cong., 1st Sess. 22, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 201. Concomitant with the delegation to the securities industry of substantial self-regulatory responsibilities, Congress, by enacting SIPA and creating the "SIPC fund", imposed the risks of brokerage firm failure on the industry generally and thereby created an incentive for SIPC and the industry to perform their responsibilities diligently. To shift that risk from SIPC to accountants would eliminate those incentives and thereby undermine the statutory purposes.

The provision of Section 6(f)(1) of SIPA by which SIPC is subrogated only to customer claims against the debtor's estate therefore is entirely consistent with the Congressional intent that SIPC (and the brokerage firms which contribute to its "fund") bear the responsibility and burden of providing to the customers the protection that Congress specified they are to receive under SIPA, and that SIPC and the industry not delegate their duties to prevent brokerage firm failures and the risks thereof to accountants. To permit SIPC to sue here as subrogee therefore requires not only the granting to SIPC of subrogation rights in addition to those expressly specified

in Section 6(f)(1) of SIPA, but also requires shifting the burden of providing the protection that Congress thought necessary from the party (SIPC) that Congress expressly charged with the duty to provide such protection to another party (Touche Ross) of whom Congress made no mention (*see also* p. 79, *supra*).

Subrogation is an equitable remedy, and should be unavailable to SIPC here unless without it Touche Ross will be "unjustly enriched" at SIPC's expense. *See* RESTATEMENT OF SECURITY § 141 (1941); RESTATEMENT OF RESTITUTION §162 (1937). Touche Ross will not be "unjustly enriched" should SIPC, and not Touche Ross, ultimately bear the burden of providing the protection to customers that SIPC was created by Congress in order to provide. More significantly, in order to effectuate Congress' goals, it is not "necessary" to shift that burden from SIPC to Touche Ross.

2. It was error for the Court of Appeals majority to have spoken of any "windfall benefit [to Touche Ross] from the existence of SIPC" (A.202). The damages that SIPC seeks to recover are not damages that, but for the existence of SIPC, Touche Ross would have been required to pay, because SIPC's theory is that Touche Ross' negligence and malpractice impeded the operation of the "early warning system" that SIPC is required to maintain, and that if SIPC had not thereby been prevented from properly monitoring Weis' financial condition, the damages for which SIPC sues might never have occurred. While it may be assumed that Congress hoped that the regulatory scheme, including the "early warning system", would achieve its objectives, there is no evidence that it intended that accountants who audit Section 17(a) reports should be liable, upon the regulatory scheme's failure to achieve those objectives, for damages that might have been avoided had it functioned more adequately. Permitting SIPC to recover those damages therefore would impose onerous new liabilities on accountants such as Touche Ross.

There is another reason why it is specious to talk of a "windfall" for Touche Ross. If Touche Ross' negligence and malpractice actually were the proximate cause of Weis' failure, the State courts can be expected to award to the Trustee, and to require Touche Ross to pay, those damages to which the Trustee (as Weis' successor) is entitled. The Weis estate thereby will be augmented to the extent that Touche Ross may be responsible for the Weis debacle. SIPC, as subrogee of customer claims *against the Weis estate,* will share in the distribution of the assets of that estate to the extent that it is entitled. There is no evidence that Congress intended that SIPC have any greater rights, or Touche Ross any greater liability.

3. The Court of Appeals majority also erred by premising its subrogation holding upon a purported "intent of Congress . . . that SIPC be able to recoup its losses from solvent wrongdoers" (A.202). The majority cited no evidence of that purported Congressional intent, and, in fact, there was no such intent. The express provisions of SIPA giving SIPC the right to recoup its losses refer only to SIPC's right to receive payments from the single and separate fund or the general estate of the debtor, and not from third parties. *E.g.,* 15 U.S.C. §§ 78fff(c)(2)(B)(i), 78fff(c)(2)(B)(ii), 78fff(f)(1) (1970). The legislative history sets forth the actual Congressional intention that any recoupment by SIPC would be from the debtor's estate and not from third parties such as Touche Ross, with the House Report on the bill that became SIPA stating that

> "It is, of course, hoped and contemplated that, when the liquidation proceedings are completed, SIPC will

receive back some moneys *from the trustee"* (emphasis added). H.R. REP. NO. 91-1613, *reprinted in* [1970] U.S. CODE CONG. & AD. NEWS 5254, 5262.[55]

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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[55] The only authority cited by the majority (A.202) that discusses SIPC's subrogation rights is *dictum* in *Securities & Exchange Commission* v. *Albert & Maguire Securities Co.*, 560 F.2d 569, 574 (3d Cir. 1977), for which the Third Circuit offered no authority or supporting analysis, and which in fact was inconsistent with the theory under discussion there, *viz.*, that the Trustee might have the power to obtain and sue upon assignments of customer rights of action.

APPENDIX

STATUTES AND RULES

Securities Exchange Act of 1934

Section 17(a), 15 U.S.C. § 78q(a), as in effect prior to the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975):

"Accounts and Records, Reports, Examinations of Exchanges, Members, and Others

"SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

Section 18(a), 15 U.S.C. § 78r(a):

"Liability for Misleading Statements

"SECTION 18. (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration state-

ment as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisidiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant."

Securities Investor Protection Act of 1970

Section 6(b)(1), 15 U.S.C. § 78fff(b)(1):

"(1) Trustee powers.—A trustee appointed under section 5(b)(3) (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. . . ."

Section 6(f)(1), 15 U.S.C. § 78fff(f)(1):

"(f) SIPC advances to trustee.—

(1) Advances for customers' claims.—In order to provide for prompt payment and satisfaction of the net equities of customers of debtor,

SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for such customer; except that—

(A) insofar as all or any portion of the net equity of a customer is a claim for cash, as distinct from securities, the amount advanced by reason of such claim to cash shall not exceed $20,000;

(B) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(C) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights) or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor; and

(D) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy claims of any customer who is a broker or dealer or bank other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise, that claims of such broker or dealer or bank against the debtor arise out of transactions for customers of such broker or dealer or bank, in

which event, each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

"To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

SEC Rules

Rule 17a-5, 17 C.F.R. § 240.17a-5, as in effect prior to SEC revisions of 1975, 40 F.R. 59712-17 (Dec. 30, 1975):

"§ 240.17a-5 Reports to be made by certain exchange members, brokers and dealers.

"(a) *Filing reports.* (1) This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to section 15 of the act.

(2) Every member, broker or dealer subject to this rule shall file reports of financial condition containing the information required by Form X-17A-5, as follows: (i) A report shall be filed as of a date within each calendar year, except that *(a)* the first such report of a member, broker or dealer (other than one succeeding to and continuing the business of another member, broker or dealer) shall be as of a date not less than one nor more than five months after the date on which such member, broker or dealer becomes subject

to this rule (in the case of a registered broker or dealer this shall be the date the registration becomes effective) and *(b)* a member, broker or dealer succeeding to and continuing the business of another member, broker or dealer need not file a report as of a date in the calendar year in which the succession occurs if the predecessor member, broker or dealer has filed a Form X-17A-5 report in compliance with this rule as of a date in such calendar year; (ii) such reports shall be filed not more than 45 days after the date of the report of financial condition; and (iii) reports for any two consecutive years shall not be as of dates within four months of each other. The reports provided for in this rule shall be filed in duplicate original with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business.

(b) *Nature and form of reports.* Each report of financial condition filed pursuant to paragraph (a) of this section shall be prepared and filed in accordance with the following requirements:

(1) The report of a member, broker or dealer shall be certified by a certified public accountant or a public accountant who shall be in fact independent: *Provided, however,* That such report need not be certified if, since the date of the previous financial statement or report filed pursuant to § 240.15b1-2 or this section, (i) said member has not transacted a business in securities directly with or for other than members of a national securities exchange; has not carried any margin account, credit balance or security for any person other than a general partner; and has not been required to file a certified financial statement with any national securities exchange; or (ii) his

or its securities business has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (iii) his or its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer. A member, broker or dealer who files a report which is not certified shall include in the oath or affirmation required by paragraph (b) (2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the certification requirements.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, (i) the financial statement and supporting schedules are true and correct and (ii) neither the member, broker, or dealer, nor any partner, officer, or director, as the case may be has any proprietary interest in any account classified solely as that of a customer. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer

(3) If the schedules furnished pursuant to the requirements of items (a), (b), and (c) of part II

and the supplementary accountant's certificate furnished pursuant to the audit requirements of Form X-17A-5 are bound separately from the balance of the report, they shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any State, by national securities exchanges and national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any national securities association or national securities exchange which give to customers of a member, broker or dealer the right, upon request to such member, broker, or dealer, to obtain information relative to his financial condition.

(c) *Use of certain statements filed with the Securities and Exchange Commission, State Commissions and National Securities Exchanges.* (1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) of this section may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein, *Provided,* That (i) the copy so included reflects his financial condition as of a date not more than 45 days prior to the filing thereof with the Commission, and (ii) the report, as filed with this Commission, meets the requirements of this rule and Form X-17A-5 and contains the information called for by that form.

(2) At the request of any member, broker, or dealer who is (i) an investment company registered under the Investment Company Act of 1940, or (ii) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept any statement of his financial condition filed pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934 or section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to this rule. Such a filing shall be deemed to satisfy the requirements of this rule for any calendar year in which such a financial statement is filed, *Provided*, That the statement so filed meets the requirements of the other rules under which it is filed with respect to time of filing and content.

(d) *Extension of time for filing reports.* In the event any member, broker, or dealer finds that he cannot file his report for any year within the time specified in paragraph (a) or (c) of this section without undue hardship, he may file with the Commission an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date. The application shall be deemed granted unless the Commission, within ten days after receipt thereof, enters an order denying the application.

(e) *Exemptions.* Any "bank", as defined in section 3(a)(6) of the Act (48 Stat. 882; 15 U.S.C. 78c) shall be exempt from the provisions of this section.

(f) *Qualifications of accountants.* The Commission will not recognize any person as a

certified public accountant who is not a duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(g) *Accountant's certificate*—(1) *Technical requirements.* The accountant's certificate shall be dated, shall be signed manually, and shall identify without detailed enumeration the items of the report covered by the certificate.

(2) *Representations as to audit.* The accountant's certificate (i) shall contain a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers, and including, if with respect to significant items in the report covered by the certificate any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission, (ii) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (iii) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case.

(3) Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (h) of this section.

(h) *Accountant's certificate; options to be expressed.* The accountant's certificate shall state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein.

(i) *Accountant's certificate; exceptions.* Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and, to the extent practicable, the effect of each such exception on the related item of the report shall be given.

(j)(1) If a broker or dealer holding any membership interest in and subject to the capital rules of a national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b)(2) thereof ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission, as of the date of such event:

(i) A proof of money balances of all ledger accounts in the form of a trial balance;

(ii) A computation of aggregate indebtedness and net capital made in accordance with § 240.15c3-1;

(iii) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(iv) Ledger net credit balances of money borrowed from banks, trust companies, and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each

loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (*a*) Securities carried for the accounts of customers, (*b*) securities owned by the broker or dealer or by any general or special partner or any director or officer of such broker or dealer, and (*c*) any other securities, and

(v) The aggregate amount of customers' ledger debit balances.

The report shall be filed at the Commission's principal office in Washington, D. C., and in duplicate original with the Regional Office of the Commission for the region in which the broker or dealer has his or its principal place of business; *Provided, however,* That such report need not be made or filed if the Commission, upon written request or upon its own motion exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement; *Provided further,* That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by subparagraph (1) of this paragraph shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner, or if a corporation, by the chief executive officer,

or in his absence, by the person authorized to act in his place.

(3) For the purposes of this § 240.17a-5(j), "membership interest" shall include the following: Full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(i) For the purposes of this section and § 240.15c3-1(b)(2), any broker or dealer shall be deemed to have ceased to be a member in good standing of such exchange when he or it has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker or dealer's membership interest in such exchange.

(4) Whenever any national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b) (2) thereof takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event."

Federal Rules of Civil Procedure

Rule 17(a), as amended Feb. 28, 1966:

"(a) **Real Party in Interest.** Every action shall be prosecuted in the name of the real party in interest. An executor, administrator, guardian, bailee, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another, or a party authorized by statute may sue in his own name without joining with him the party for whose benefit the action is brought; and when a statute of the United States so provides, an action for the use or benefit of another shall be brought in the name of the United States. No action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest; and such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest."